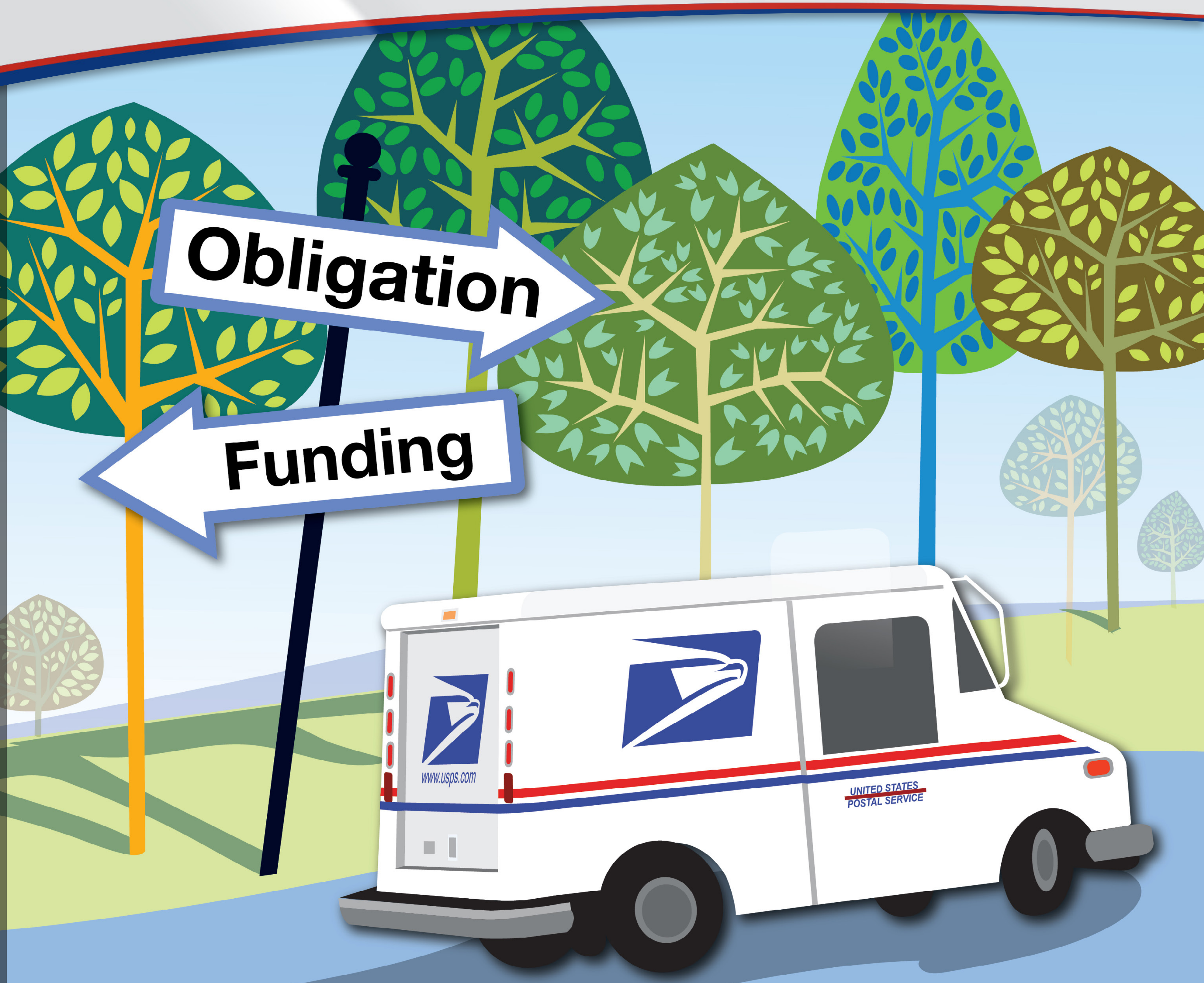
OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

Funding the Universal Service Obligation



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OFFICE OF INSPECTOR GENERAL
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Executive Summary

Currently, the U.S. Postal Service has two legal monopolies — a monopoly on most letter mail and exclusive access to the mailbox. Historically, the purpose of these monopolies is to help ensure the Postal Service has adequate revenue to cover the cost of its universal service obligation (USO).[1] However, the combination of the steady decline in letter mail and the price cap on the monopoly products has begun to decrease the monopoly-related revenue. This, in turn, has eroded the ability of the Postal Service to fund its USO.

This problem is not unique to the United States. Other posts have addressed this problem by reducing their obligations, increasing their revenue — either through greater pricing flexibility or additional funding alternatives — or both.

In the U.S. Postal Service Office of Inspector General's (OIG) first paper on the USO, *Guiding Principles for a New Universal Service Obligation*, we discussed the need to better define and modify the USO and identified a need for a quantitative survey on the value of the postal services that make up the USO.[2] In a follow-up paper, *What Postal Services Do People Value the Most?*, the OIG worked with Gallup to develop and implement a survey to meet this outstanding need.[3] In response to our papers, stakeholders suggested that we next turn to studying how to fund the USO.

Highlights

Traditionally, the postal monopolies have ensured that the Postal Service has adequate funding to cover the cost of its universal service obligation (USO).

The combination of the decline in letter mail and the price cap has challenged the ability of the monopolies to earn sufficient revenue.

Given that there is seemingly little appetite to reduce the obligations, it is time to explore either strengthening the existing funding source or finding a new one.

The OIG looked at various USO funding alternatives and found three viable — and not mutually exclusive — alternatives: monopoly with increased pricing flexibility, direct subsidy, and diversification.

While greater pricing flexibility potentially could provide enough revenue, the use of either or both diversification and direct subsidy can help mitigate the need for large price increases.

1 U.S. Postal Service, *Universal Service and the Postal Monopoly: A Brief History*, October 2008, https://about.usps.com/universal-postal-service/universal-service-and-postal-monopoly-history.pdf.
2 U.S. Postal Service Office of Inspector General (OIG), *Guiding Principles for a New Universal Service Obligation*, Report No. RARC-WP-15-001, November 17, 2014, https://www.uspsoig.gov/sites/default/files/document-library-files/2015/rarc-wp-15-001_0.pdf.
3 OIG, *What Postal Services Do People Value the Most? A Quantitative Survey of the Postal Universal Service Obligation,* Report No. RARC-WP-15-007, February 23, 2015, https://www.uspsoig.gov/sites/default/files/document-library-files/2015/rarc-wp-15-007_0.pdf.

In this paper, we look at several USO funding alternatives and suggest three viable options that can be used alone or in combination.

In this paper, we look at several USO funding alternatives and suggest three viable options that can be used alone or in combination. They are

- the revenue from the current monopolies with greater pricing flexibility,
- direct subsidies to compensate the Postal Service for specific targeted obligations, and
- diversification, allowing the Postal Service to earn revenue from non-mail products and services.

Each of the alternatives has its own pros and cons, and policy makers will have to decide which alternative, or which mix of alternatives, is most suitable. For example, it may be possible to fix the funding issue by simply allowing the Postal Service to increase prices beyond the current price cap. However, if there is little tolerance for higher prices, price increases could be mitigated by using one or both of the other alternatives — direct subsidy and diversified revenue stream — in addition to more pricing flexibility. In conclusion, while there may be no one perfect funding mechanism for the USO, it may be possible to combine several alternatives to ensure that the Postal Service has sufficient revenue to cover the entire cost of the USO.

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Executive Summary

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Observations

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Observations

Historically, the funding for the USO in the U.S. has been through the creation of two legal monopolies — the private express statutes and the mailbox monopoly.

Introduction

The U.S. Postal Service Office of Inspector General (OIG) has issued two papers on the universal service obligation (USO) — the set of requirements that ensure that all users of the mail receive a minimal level of postal services at an affordable price. In the first paper, *Guiding Principles for a New Universal Service Obligation,* the OIG discussed the need to better define and modify the U.S. Postal Service's USO and provided a set of guiding principles to help with this redesign.[4] In addition, we identified the need for a quantitative survey on how much value the American public places on the various attributes of the USO. In our second paper, *What Postal Services Do People Value the Most?*, we worked with Gallup to develop and implement a survey to meet this outstanding need.[5] The survey included four attributes: frequency of delivery, mode of delivery, access to post offices, and price. The results of this survey demonstrated that postal customers still value certain postal services, especially delivery to the door or curb and access to post offices.

In response to our papers, stakeholders suggested that we next turn to studying how to fund the USO.[6] In fact, while some countries have turned to reducing or modifying their universal service obligation, others have turned to measures that have increased their revenue to fund the USO — through increased pricing flexibility or alternative funding alternatives.[7] And, in some cases, a combination of reduced obligations and increased funding have been employed.[8]

Funding for the USO Is Constrained by the Price Cap and Falling Volumes

Historically, the funding for the USO in the U.S. has been through the creation of two legal monopolies — the private express statutes and the mailbox monopoly. The private express statutes, commonly referred to as the reserved area, excludes private companies from delivering most letter mail.[9] The mailbox monopoly restricts the use of the mailbox to only the Postal Service.[10] While the link between the monopolies and funding the USO is not written explicitly into statute, this connection is generally accepted and is discussed in both the Postal Service's and the Postal Regulatory Commission's (PRC) reports on the USO. For example, in the PRC report, they state that "Under the current system, the monopoly is maintained to offset the costs placed on the Postal Service by the USO."[11] In the Postal Service's report, they make a strong argument that the purpose of the monopolies is to fund the USO.[12] To bolster this argument, they provide a summary of the legislative history that supports it.[13]

The idea behind the two monopolies is that they allow the Postal Service to charge a higher mark-up on the monopoly products, resulting in increased revenue that can be used to fund the USO. However, while it is generally accepted that the monopolies are

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4 OIG, *Guiding Principles for a New Universal Service Obligation*, Report No. RARC-WP-15-001, November 17, 2014, https://www.uspsoig.gov/sites/default/files/document-library-files/2015/rarc-wp-15-001_0.pdf.

5 OIG, *What Postal Services Do People Value the Most? A Quantitative Survey of the Postal Universal Service Obligation,* Report No. RARC-WP-15-007, February 23, 2015, https://www.uspsoig.gov/sites/default/files/document-library-files/2015/rarc-wp-15-007_0.pdf.

6 Feedback from stakeholders occurred primarily during two roundtable events, held on September 22, 2014 and April 1, 2015, to discuss our USO papers.

7 An example of where obligations were reduced is New Zealand Post; they have requested and received a reduction in their obligation related to frequency of delivery from 5 to 3 days in major towns and cities: https://www.nzpost.co.nz/about-us/media-centre/delivery-changes-for-standard-mail. An example of increased pricing flexibility is that in 2012, Ofcom eliminated the majority of regulatory control on Royal Mail's prices. The price cap was only maintained on second-class stamps. http://media.ofcom.org.uk/analysts/regulated-prices/. For examples of alternative USO funding sources, see WIK report in Appendix A.

8 For example, the incumbent post in Portugal, CTT Correios, has reduced its requirements surrounding quality and received approval for higher prices. Accenture, *Achieving High Performance in the Post and Parcel Industry*, *Accenture Research and Insights 2015*, 2015, https://www.accenture.com/t20151116T035247__w__/us-en/_acnmedia/Accenture/Conversion-Assets/DotCom/Documents/Global/PDF/Dualpub_23/Accenture-Achieving-High-Performance-in-the-Postal-Industry-2015-V2.pdf, p. 8.

9 There are exceptions to this rule including letters that are over 12.5 ounces and letters that are paid at an amount that is at least 6 times the rate of the first ounce of a single-piece First-Class Mail letter. In addition, private entities may deliver letters if they have appropriate postage on them. See 39 U.S.C. § 601, 18 U.S.C. §1693-1696, and 39 C.F.R. Parts 310 and 320..

10 18 U.S.C. §1725.

11 Postal Regulatory Commission, *Report on Universal Postal Service and Postal Monopoly*, December 2008, http://www.prc.gov/docs/61/61628/uso%20report.pdf, p.199.

12 U.S. Postal Service, *Report on Universal Postal Service and The Postal Monopoly,* October 2008, https://about.usps.com/universal-postal-service/usps-uso-report.pdf.

13 The historical discussion is found in Appendix A of the the Postal Service's report. It appears as a stand-alone supporting document on their website. U.S. Postal Service, *Universal Service and the Postal Monopoly: A Brief History*, October 2008, https://about.usps.com/universal-postal-service/universal-service-and-postal-monopoly-history.pdf.

What can be stated with certainty is that it is becoming more and more challenging to earn sufficient funding from the monopoly products as revenues from these products face two constraints.

in place to help ensure adequate revenue, there is no explicit rule that defines how much of the mark-up on monopoly products is "dedicated" to fund the USO. In addition, as discussed in our previous papers, there is no explicit definition of the USO. Without knowing explicitly what the USO covers, it is impossible to accurately estimate its costs. Therefore, it is difficult to say whether the monopolies provide sufficient funding to cover the cost of the USO.[14]

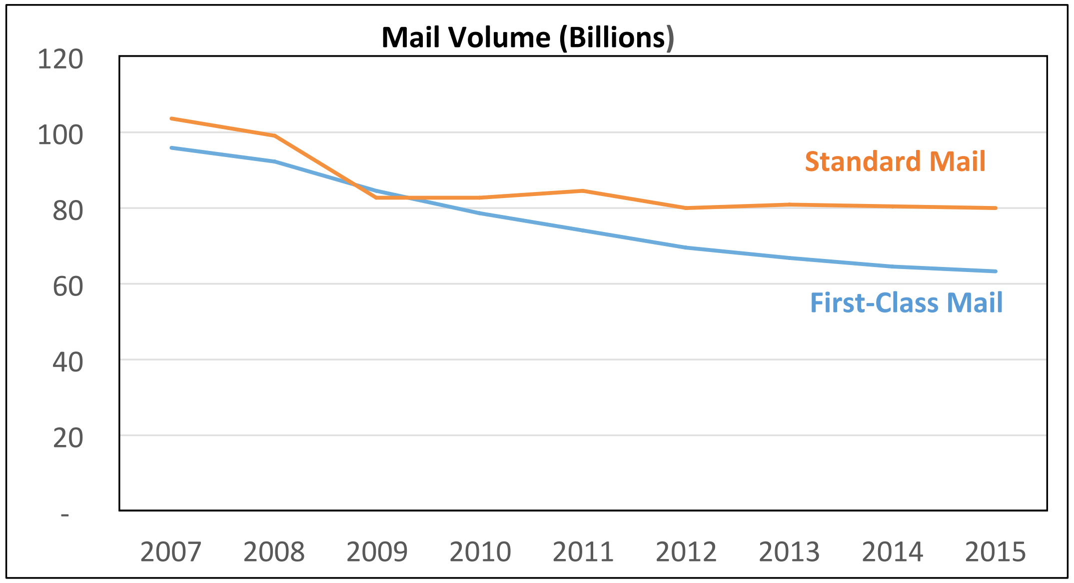
What can be stated with certainty is that it is becoming more and more challenging to earn sufficient funding from the monopoly products as revenues from these products face two constraints. The first is the price cap on market dominant products, which limits the average rate increase for each class of mail to the change in the CPI over the last 12 months.[15] The second constraint is that volumes of the monopoly products, mainly First-Class Mail and Standard Mail, have been declining at worst and stagnating at best. Figure 1 displays these volume declines.

Furthermore, stakeholders have expressed concern about the ability to fund the USO through the postal monopolies.[16] This concern was raised most recently by several witnesses in a hearing on the Postal Service before the U.S. Senate Committee on Homeland Security and Government Affairs.[17] In light of these ongoing concerns, we looked at alternatives to funding the USO.

Figure 1: Monopoly Volumes

Ability to Fund the USO Is Constrained By Price Cap and Declining or Stagnating Volumes

The combination of the current CPI price cap and declining or stagnating letter volume constrains the ability of the monopolies to earn sufficient revenue to cover the cost of the universal service obligation. If the Postal Service were to file for a rate increase today, the cap would be only 0.12%.



Source: OIG Analysis using PRC and Postal Service data.

USO Funding Alternatives

In order to get an idea of what types of funding alternatives are available, we asked WIK-Consult (WIK) to provide us with a report on the funding alternatives that have been used in European countries. Table 1 presents a summary of their findings, and their full report can be found in Appendix A.

14 While the PRC provides an estimate of the cost of the USO and the value of the monopoly each year in its annual report, these estimates cannot necessarily be used for the determination of whether the monopoly provides sufficient funding for the USO. The PRC's estimates rely on static models, that is, the value of the monopoly is calculated assuming the USO stays constant and vice-versa. In reality, the two are linked and a change in one will affect the value of the other. In addition, as pointed out by PRC (A) Chairman Taub at the January 21st Senate Hearing, until the USO is defined, there will continue to be disagreement on what the USO costs.

15 The price cap applies to each class of mail. This means that prices on products within the class may increase by more than the cap, but the average increase for the class as a whole must be no higher than the cap. The PRC's current estimate of the price cap is a mere 0.12 percent. In addition, the cap has stayed under 2 percent since the beginning of 2013. http://www.prc.gov/sites/default/files/CPI%20012016.pdf. There are additional price restrictions as well. For example, workshare discounts must not exceed 100 percent of the estimated cost savings. While there are exclusions to this rule, it is expected that over time, the Postal Service will adjust workshare discounts to meet this requirement.

16 Stakeholders have also expressed concern about the challenge the Postal Service faces in remaining financially solvent, but this paper focuses on the concern about the ability to fund the USO. In reality, these two things are inextricably linked.

17 *Laying Out the Reality of the United States Postal Service, Before the U.S. Senate Committee on Homeland Security and Government Affairs,* 114th Congress (January 21, 2016), http://www.hsgac.senate.gov/hearings/laying-out-the-reality-of-the-united-states-postal-service. For example, Witness Robert G. Taub expressed that Congress needs to consider what is needed for universal service and how it is to be funded (at 35:22 in hearing video). Witness James E. Millstein also expresses concern that the monopoly does not really exist and the universal service obligation is slowly "choking the Postal Service to death" (at 50:27 in hearing video).

Accenture identified diversification as one of the key strategies employed by the highest performing posts, and suggested that diversification is no longer optional.

Table 1: Summary of WIK's Analysis of USO Funding Alternatives in European Posts

Type	Description	Summary of WIK's Assessment
Compensation fund	A fund used to compensate a post for the cost of the USO. The fund is paid into by other service providers or by customers.	It is costly to administer for market players and regulators. Also it is unlikely to raise sufficient funds since the posts are still the dominant players in the market.
Public funding from the general state budget (direct subsidy)	This includes any type of direct payment made by the government to cover the cost of obligations. Typically in foreign posts, the payments are targeted to specific obligations.	WIK found this to be the most appropriate funding mechanism used in European posts. It has relatively low administration costs. Policy makers are accountable for both determining the USO levels and paying for them.
State liability for legacy labor costs	While this is not a direct funding mechanism for the USO, it is often discussed in the context of providing the USO after a post is liberalized. It involves the government taking over responsibility of legacy costs that were incurred while the post was a government agency.	This works as a transitory instrument to compensate posts for excess labor costs when moving to privatization. However, it has lacked transparency when used.
Public procurement of universal service	Parts of the USO are publicly auctioned off; the winning bidder takes the minimum subsidy to provide the service.	Good in theory, but so far has not been used in practice. It is not compatible with having a statutory monopoly. It will be difficult to design procurements to attract bids from operators other than the post.

Upon reviewing WIK's report, we realized that two of the four alternatives analyzed did not appear to be applicable USO funding alternatives for the U.S. Postal Service at this time — state liability for legacy labor costs and public procurement of universal service. In Europe, state liability for legacy labor cost has been used when the post is about to be privatized in order to make the post more attractive for sale. Public procurement of universal service would depend on either partial or full liberalization (modification or elimination of the monopoly). Since neither privatization nor liberalization is being currently proposed legislatively, we did not include either of these two alternatives in our analysis.

We also identified an option that, while not typically discussed as an explicit funding alternative for the USO, has helped other posts increase their revenue. This alternative is allowing posts to offer non-mail products, often referred to as diversification. In fact, Accenture identified diversification as one of the key strategies employed by the highest performing posts, and suggested that diversification is no longer optional.[18] In addition, we thought it was prudent to consider the effectiveness of the current monopoly if greater pricing flexibilities were introduced. Therefore, our report discusses the potential of four alternatives:

- current monopolies with additional pricing flexibility,
- direct subsidy,
- diversification, and
- compensation fund.

18 Accenture, *Achieving High Performance in the Post and Parcel Industry*, *Accenture Research and Insights 2015*, 2015, p. 7.

It is possible that if the Postal Service were given more flexibility, through modification of the price cap, it could earn sufficient revenues from its monopolies to cover the cost of the USO.

Each are discussed in more detail below. Please note that the options below are not meant to replace the current monopolies, but instead could be used in addition to them.

Current Monopoly with Additional Pricing Flexibility

As mentioned above, the current price cap restricts the average price increase for each class of market dominant mail to the 12-month change in the CPI. The combination of the cap and other pricing regulations, such as requirements on workshare discounts, constrains the Postal Service's pricing flexibility. It is possible that if the Postal Service were given more flexibility, through modification of the price cap, it could earn sufficient revenues from its monopolies to cover the cost of the USO.[19]

The advantage of this USO funding alternative is that it is fairly easy to implement since it relies on the traditional source of revenue to fund the USO. In addition, an opportunity for implementing this approach is fast approaching. The Postal Accountability and Enhancement Act requires the PRC, ten years after enactment of the act, to review the pricing rules and gives them the authority to make changes.[20] This ten-year review will begin in December 2016.

Another advantage of this approach is that it matches the source of the funding with the group of individuals who benefit from universal service — postal ratepayers. Overall, this may be acceptable, as long as it does not unfairly burden those who need the USO the most, especially those who can least afford to pay higher prices. For example, the USO is thought to protect those who live in rural areas, where mail delivery is more expensive and there are fewer alternatives to mail delivery.[21] Therefore, it would not be consistent with the USO to change prices in a way that would put a disproportionately large share of the burden on those who live in rural areas, as it may negatively affect their ability to send and receive mail.

A potential disadvantage of this alternative is that mailers of the monopoly products already provide the majority of the Postal Service's contribution to institutional costs and would most likely not embrace an alternative that puts more of the burden on them.[22]

The effectiveness of this alternative may depend on how high prices need to be to fund the USO. Current estimates of price elasticity, a measure of how much volume will change as a result of a change in price, demonstrate that revenue can be increased by moderate price increases on letter mail. However, estimated price elasticities based on small historical price changes do not give any insight into how mail volume would change in response to larger price increases. Furthermore, it is generally agreed that part of the USO is to keep rates affordable. Allowing significantly large price increases may actually harm the ability of the post to meet this part of the USO.

Direct Subsidy

A second alternative to consider is one that WIK found to be the most effective alternative funding source in European posts.[23] It involves providing a direct subsidy from the government to cover the cost of a specific obligation. For example, the French government compensates La Poste for lower tariffs for press items.[24] WIK found an advantage to this alternative is that policy makers are accountable for both determining the USO levels and paying for them.

19 For a few examples of other price caps see OIG, *Revisiting the CPI-Only Price Cap Formula,* April 2013, https://www.uspsoig.gov/sites/default/files/document-library-files/2015/rarc-wp-13-007_0.pdf. Additional pricing flexibilities could be obtained by applying the price cap globally across all market dominant products or changing the other pricing rules and requirements. For example, currently the price cap trumps the requirement that each product cover its cost. This relationship could be reversed.
20 39 U.S.C. § 3622(d)(3).
21 U.S. Postal Service, *Report on Universal Postal Service and The Postal Monopoly*, October 2008, https://about.usps.com/universal-postal-service/usps-uso-report.pdf, p. 29.
22 Currently First-Class Mail provides almost 60 percent of the Postal Service's contribution to institutional costs and Standard Mail provides almost 24 percent. U.S. Postal Service, *Cost, Revenue, and Analysis Report*, http://about.usps.com/who-we-are/financials/welcome.htm.
23 WIK Report, see Appendix A.
24 Ibid, p. 13.

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While this is not a traditional source of USO funding, it is not uncommon for foreign posts to earn siginficant revenues from non-mail products.

Another advantage of this approach is that it ensures the full funding of the specific obligation, since by definition, the payment is based on the estimated cost of the obligation. However, a disadvantage of this alternative is that estimating the cost of any obligation is rarely clear cut. The difficulty in estimating the cost of the USO, and therefore the size of the needed subsidy, can be seen in the PRC's recent proceeding on which activities should be included in the cost of the USO.[25] The PRC and the Postal Service clearly have different opinions on which activities should be included and the difference is in the billions of dollars.[26] However, this controversy can be somewhat mitigated, and possibly eliminated, by tying subsidies to specific activities, similar to what is done in European posts. For example, in the United Kingdom, the government provides a subsidy to allow Royal Mail to keep rural post offices open.[27] By limiting the subsidy to a direct activity, it makes it easier to tie the subsidy to a specific cost. In the United States, there are a few specific obligations that would be fairly easy to estimate the associated cost (or forgone revenue). One example would be the additional cost of providing mail to Alaska, commonly referred to as the Alaska subsidy. Another may be the cost of keeping underutilized post offices open.[28]

It should be noted that this approach results in revenues being obtained from a source other than postal ratepayers. Postal ratepayers may see this as an advantage, but others may view this as being unfair, especially if they believe that their tax dollars are being used to subsidize certain mailers. However, given the ubiquity of the Postal Service, this may not be a concern for many.

One disadvantage of this alternative is that there has been some history in the United States with the government not paying the Postal Service revenues it is owed. For example, in the early 1990s the government failed to provide sufficient funds for nonprofit and other types of reduced rate mail. To pay the Postal Service back, a 1993 law promised to make annual $29 million payments to the Postal Service until 2035. While payments were made through 2010, they were not made from 2011 to 2014, and it is unknown if the recent resumption of payments is an anomaly or a sign of change.[29] Interestingly, WIK did not find this to be a problem in European countries.

Diversification

Diversification refers to allowing a post to offer products and services beyond its core mail products. While this is not a traditional source of USO funding, it is not uncommon for foreign posts to earn significant revenues from non-mail products.[30] In theory, revenues from non-mail services could be used to cover the cost of the USO. For example, given that current law contains a requirement that competitive products cover their costs and make a reasonable contribution to institutional cost, it seems feasible that a similar requirement could be placed on non-mail services.[31]

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25 Postal Regulatory Commission Proceeding, Docket No. PI2014-1, www.prc.gov.
26 Ibid. In its estimate of the cost of the USO, the PRC includes a number of different cost elements under three broad categories (1) the cost of providing services to all areas of the nation, (2) the estimated revenue not received due to public service and uniform pricing requirements, and (3) other public services and activities. The PRC expressed concern that its estimate of the cost of "other public services or activities" might be too narrow. In order to address that concern, it established Docket No. PI2014-1 to seek public comments on what activities should be included in this category of USO costs. In that docket, the Postal Service provided a list of other activities that could potentially be included. While some of the activities did not have cost estimates, the Postal Service claimed that these activities could add billions to the PRC's estimated cost of the USO. Some of the activities that the Postal Service argued should be included are employee and retiree health benefits, federal retirement benefits, binding arbitration of labor issues, the cost of the Postal Inspection Service and the Office of the Inspector General, workers compensation, emergency detection and response, and purchasing requirements. In its ruling, the PRC stated what criteria it would use to determine what activities were included in the cost of the USO in its next annual report. However, the PRC did not explicitly state which activities would be included as a result of applying this criteria.
27 WIK Report, see Appendix A, p. 32.
28 PRC, *FY 2015 Annual Report*, http://www.prc.gov/sites/default/files/reports/PRC%20Annual%20Report%20FY%202015.pdf, p. 41. The PRC estimates the FY 2014 value of the Alaska Air Subsidy to be $112 million and the value of maintaining small post offices to be $157 million.
29 OIG, *Is Revenue Forgone a Bad Debt?*, Report No. RARC-WP-16-004, February 22, 2016, https://www.uspsoig.gov/sites/default/files/document-library-files/2016/RARC-WP-16-004_0.pdf.
30 Accenture, *Achieving High Performance in the Post and Parcel Industry, Accenture Research and Insights 2015*, p. 4.
31 39 U.S.C. § 3633.

The benefit of allowing diversification for a product that utilizes the network is that it benefits the users of mail in two ways.

Currently the Postal Service is limited in the nonpostal services it can provide, as PAEA limited the Postal Service to provide only those nonpostal services that were offered as of January 1, 2006.[32] Therefore, it is possible that a change in the law would be needed for diversification to be an effective revenue source. Whether or not allowing the Postal Service to use non-mail products to help ease the burden of the USO would be considered appropriate, depends on finding the "right" product. To help with this assessment, legislators and regulators could devise an evaluation framework. For example, one that meets the following four conditions: (1) the market is not currently providing sufficient amounts of the product at a reasonable price, (2) the new product fits into the Postal Service's core competencies or leverages its existing network, thereby allowing it to benefit from economies of scope, (3) the Postal Service can legally provide it as the product serves a public purpose, and (4) the Postal Service can make a positive contribution from providing it. One possible product suggested by the OIG is that the Postal Service utilize its large network of post offices to provide some non-bank financial services to currently underserved markets.[33] Providing this type of service would both increase postal revenues and provide citizens with an unmet or undermet need.

The benefit of allowing diversification for a product that utilizes the network is that it benefits the users of mail in two ways. First, it helps the Postal Service earn additional revenue. Second, by allowing more products to leverage the existing fixed infrastructure, more users share covering the fixed costs of the network, which in turn could lower prices for all users, both mail and non-mail.

One risk associated with diversification that should not be ignored is the potential for the new product to be unprofitable, which in turn, would harm the Postal Service's ability to fund the USO. This could occur if the Postal Service miscalculates the potential cost, revenue, or market share of a new product or service. This has occurred in other posts. For example, DHL lost billions of dollars when it attempted to move into the U.S. postal market.[34] However, this risk can be mitigated by the Postal Service starting with small market tests — as it has done with delivering groceries and same-day parcel delivery. In addition, as is done with competitive products, the PRC could have compliance procedures to ensure that the Postal Service is not entering into any lines of service that would be detrimental to its finances.

Compensation Fund

The fourth alternative is the use of a compensation fund. The general idea of this alternative is that all service providers or customers pay into the fund, and the monies from the fund are used to pay for the USO.

As discussed in WIK's report in Appendix A, this alternative has been used unsuccessfully in European posts. One of the main issues has been that it is costly and difficult to administer. The second issue is that so far it has not resulted in sufficient funds. Even with liberalization — the reduction or modification of the monopoly — to date posts are still the dominant players in the market. Therefore, compensation funds result in mainly the post paying into the fund. Given the Postal Service has a monopoly on most letter mail, a compensation fund drawing upon revenues of market entrants is not relevant for market dominant mail.

In theory, there are two ways to imagine a compensation fund being applied to competitive products. The first is to charge alternative parcel delivery companies a fee to deliver themselves. While this would be similar to what is done in foreign posts for letter mail, this would be politically infeasible. In foreign posts, compensation funds are set up around the same time the monopoly restrictions are reduced or eliminated.[35] So new entrants enter the market with the understanding they will need to pay into a fund.

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32 39 U.S.C. § 404(e).
33 OIG, *The Road Ahead for Postal Financial Services,* Report No. RARC-WP-15-011, May 21, 2015, https://www.uspsoig.gov/sites/default/files/document-library-files/2015/rarc-wp-15-011_0.pdf and OIG, *Providing Non-Bank Financial Services for the Underserved*, Report No. RARC-WP-14-007, January 27, 2014, https://www.uspsoig.gov/sites/default/files/rarc-wp-14-007-dr_0.pdf.
34 One article claimed that DHL lost $9.6 billion when it attempted to go head to head with UPS and FedEx for domestic deliveries within the United States: http://www.bloomberg.com/news/articles/2011-04-14/dhl-reboots-in-u-s-after-9-6-billion-bleed-freight-markets.
35 WIK Report, Appendix A, p. 2. The Postal Directive 97/67/EC is where compensation funds were introduced in the EU. This is the same directive that started the liberalization of posts in EU countries.

Given one of the tenants of the USO is to maintain affordable rates, policy makers may want to mitigate price increases by choosing another funding alternative to use alone or in combination with pricing flexibility.

In contrast, entities other than the Postal Service have been allowed to deliver parcels for decades.

The second way a compensation fund could theoretically work with competitive products is to charge a fee on top of postage when the private firm uses the Postal Service for last mile delivery. While this is an interesting concept, it is unclear if this structure would significantly affect revenue. The Postal Service already has the ability to maximize the contribution it earns on competitive products. In theory, if it could charge more for parcels, it would do so, even in the absence of a compensation fund. Therefore, there appears to be little advantage to the Postal Service adopting this funding mechanism.

There Is No One Right Funding Mechanism

The need for funding the USO will depend on the how the USO is defined. If there is little appetite for any of the alternatives above, policy makers could choose to redefine the USO in a manner that would reduce the cost of the obligations. However, to date, service cuts have been met with resistance from key stakeholders.[36] So it appears the answer, at least for the present time, is to consider alternatives to increase or strengthen the sources of USO funding.

Each of the alternatives has its own pros and cons, and policy makers will have to decide which alternative, or which mix of alternatives, is most suitable. As discussed above, it may be possible to fix the USO funding challenge through greater pricing flexibility. However, pricing flexibility will result in higher prices, at least for some products. Given one of the tenets of the USO is to maintain affordable rates, policy makers may want to mitigate price increases by choosing another funding alternative to use alone or in combination with pricing flexibility.

Diversification is one alternative that could be used to mitigate future price increases, by allowing the Postal Service to offer non-mail products that leverage its existing infrastructure. Any risk associated with offering a new product could be mitigated by starting with small market tests.

In addition, if policy makers feel a specific, targeted obligation is important enough, they may want to consider using taxpayer funds to subsidize a specific obligation. This would make the most sense when there is a specific and well-defined obligation with easily identified costs.

For all practical purposes, a compensation fund does not appear to be an effective alternative at this time. The experience to date has been that it is costly and difficult to administer and does not provide sufficient funding. It is also geared to posts that do not have a statutory monopoly.

Conclusion

This paper looked at alternatives to funding the USO, and identified the three that are most viable — the current monopolies with additional pricing flexibility, diversification, and direct subsidy for a specific obligation. While there is no one perfect funding mechanism for the USO, it may be possible to combine several alternatives in order to ensure that the Postal Service has sufficient revenue to cover cost of the USO.

36 In a recent hearing at the Senate, concerns about service cuts were raised, and there appeared to be support for finding funding alternatives rather than focus solely on service cuts. *Laying Out the Reality of the United States Postal Service, Before the U.S. Senate Committee on Homeland Security and Government Affairs.*

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Appendix A: WIK Report on Alternative Funding Models for the Universal Service Obligation: The European Experience

WIK-Consult • Final Report

Study for the USPS Office of Inspector General, Risk Analysis Research Center

Alternative Funding Models for the Universal Service Obligation: The European Experience

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Summary

WIK-Consult was commissioned by the Risk Analysis Research Center (RARC) of the USPS Office of Inspector General (OIG) to provide an overview of the funding mechanisms for postal universal service in Europe, how they are applied, and their advantages and disadvantages.

The study discusses approaches for funding the USO in six European countries: Belgium, France, Germany, Italy, Spain, and the United Kingdom. Country case studies describe the different types of financing mechanisms, experience with the funding mechanisms and an assessment how well the mechanisms have worked. The study concludes with an analysis of strengths and weaknesses of the various funding mechanisms in the six benchmark countries.

For the financing of (potential) net costs of the universal service, we have identified four general options:

- a compensation fund, financed by all relevant service providers or customers,
- public funding from the general state budget,
- state liability for legacy labor costs, and
- public procurement of universal services.

Then we have examined their advantages and disadvantages based on the experience in Europe. Important criteria for our analysis of strengths and weaknesses of USO funding mechanisms include the effects the mechanisms actually have, whether they provide incentives for efficiency and/or innovation, the administrative burdens and costs caused by the mechanism, what effect they have on competition and whether they violate any laws.

Our research offers the following conclusions:

- **Compensation funds** are very costly to administer for both market players and regulators. Given the dominance of USO operators in postal markets, compensation funds are unlikely to raise sufficient funds if there is a substantial USO net cost. Overall, European experience with compensation funds is poor.
- **Public funding by the state** to us appears as the most appropriate funding mechanism, if there is a documented need for external funding. It has relatively low administrative costs, and politics are accountable for both determining USO levels, and paying for them. Public funding is used in several EU countries to support universal service, including the Belgium, France, Italy, and the UK.
- **State liability for legacy labor costs** is often discussed in the context of universal service but in fact does not relate to the USO directly. We see such state liability and payments as a transitory instrument to compensate postal

operators for excessive labor cost they incur due to their public sector heritage, and to allow them to compete on equal ground with private companies.

- **Public procurement** of (parts of) the universal service is a good option in theory, as it can ensure that the USO is assumed by the most efficient operator, and help to reduce the amount of funding required to ensure the provision of the USO. For the USA, however, the major drawback of this mechanism is that it is not compatible with a statutory monopoly. And in liberalized postal markets, regulators face the difficult challenge of designing procurements so that they attract bids from operators other than the incumbent.

1 Introduction

WIK-Consult was commissioned by the Risk Analysis Research Center (RARC) of the USPS Office of Inspector General (OIG) to provide an overview of the funding mechanisms to finance the universal service obligation (USO) in Europe, how they are applied, and their advantages and disadvantages.

The aim of the study is to discuss the approaches for funding universal service obligations, and experience with those approaches in six European countries: Belgium, France, Germany, Italy, Spain, and the United Kingdom.

Table 1 Indicators of benchmark countries (2014)

Country	USO fund?	State aid?	EC state aid case?	Popu-lation?	EBIT margin
Belgium	No	Yes, mainly for providing a dense branch network and press delivery	Yes	11.2m	18.79%
France	Possibly	Yes, for the branch network and delivery of press items	Yes	65.9m	4.44%
Germany	Possibly	Yes, for legacy pension costs	Yes	80.8m	8.03%
Italy	Established	Yes, mainly for providing the USO	Yes	60.8m	3.52%
Spain	Possibly	Yes, mainly for providing the USO		46.5m	0.69%
UK	Possibly	Yes, for providing the rural network, restructuring aid and pension costs	Yes	64.3m	3.66%

Source: Annual Reports of USPs and NRAs and state aid cases of the European Commission.

The six benchmark countries present a diverse set of European countries, and diverse approaches to funding the USO (see table 1 above).

The study starts with a short description of EU (supranational) rules for USO funding given by Postal Directive and further limitations under EU competition law (e.g., EU state aid rules on services of general economic interest). The report includes country case studies that describe the different types of USO financing mechanisms in the six benchmark countries, with a focus on a description of the funding mechanisms in place, the experience with the funding mechanisms and an assessment how well the funding mechanism have worked. The study concludes with a detailed analysis of strengths and weaknesses of the various funding mechanisms in the six benchmark countries.

The study is based on desk research and interviews with postal managers (at regulators or postal operators).[1] As a part of our quality management, preliminary results and conclusions were discussed in a meeting with an official of the European Commission.

1 The authors gratefully acknowledge the experts that took time for interviews during this study: Aurélie Seghers and Özhan Zurel of BIPT (Belgium), André Meyer-Sebastian, at Bundesnetzagentur (Germany), Caroline Longman and Markham Sivak from Ofcom (UK), Yara Suárez Barrientos of CNMC (Spain), Gennaro Scarfiglieri of Poste Italiane (Italy), and Werner Stengg, Head of Unit 'Public Interest Services' at the European Commission, DG GROW.

2 EU (supranational) rules for USO funding

While EU legislation set out minimum requirements for postal universal service, the EU member states have each defined their postal universal service domestically (within the limits of EU law), and most EU member states have designated a universal service provider (USP).

This chapter discusses the key EU rules regarding financing options for the universal service obligation (USO) and their limitations.

2.1 Requirements of the Postal Directive

Article 7 para 3 and 4 of the Postal Directive[2] specifies that the USP can be financially supported by the public, either by establishing

- a public fund or
- a universal service fund to share the net cost of the USO among postal operators and/or users.

EU member states enjoy the freedom to decide the method of financing that is best adapted to their particular situation, provided that they avoid any disproportionate distortions to the functioning of the market. But in essence, both compensation mechanisms amount to the use of public funds. In the first case the funds come from general tax revenues. In the second case the compensation fund is financed by a special tax on postal service providers or their users and administered by a body independent of the beneficiaries (typically the government).

However, there are two conditions for the granting of a compensation payment: The EU member state has to determine, that the USO “entail a net cost” and “represent an unfair financial burden”. At present only a few EU member states have reported that they had deemed the burden of the universal service obligation to constitute an unfair burden on the USP; among those that have are Italy and Spain.

In about half of the EU member states the net cost has already been calculated. However, plausible estimates of the net cost of universal service are relatively scarce, because very different calculation methods were applied and often the calculation of the USP has not been verified by the NRA. In 2008, the Third Postal Directive added a new Annex I to the Postal Directive that summarizes a method of “calculating the net cost, if any, of universal service”. Since then, the EU member states have to consider the requirements of Annex I for calculating the net costs. The consensus of several

2 Directive 97/67/EC of the European Parliament and of the Council of 15 December 1997 on common rules for the development of the internal market of Community postal services and the improvement of quality of service, OJ L 15, 21.1.1998, as last amended by Directive 2008/6/EC of the European Parliament and of the Council of 20 February 2008, OJ L 52, 27.2.2008.

analyses over the last years appears to be that the 'profitability cost approach'[3] most closely corresponds to the specifications of Annex I of the Postal Directive. Of our six benchmark countries net costs were already calculated only in Belgium, Italy, and Spain.

Many EU member states already have authorized the establishment of a compensation fund. However, only a few of them actually have established a compensation fund, among them Italy. In most European countries, the compensation funds will only come into play if the USO turns out to be an unfair burden in the future. According to the Commission, "some EU Member States have recently expressed a desire to implement such compensation funds for the financing of the USO."[4]

According to Article 7 para 5 of the Postal Directive, when establishing a compensation fund and fixing the level of financial contributions, EU "Member States shall ensure that the principles of transparency, non-discrimination and proportionality are respected". In order to determine which undertakings may be required to contribute to a compensation fund, EU member states may make the granting of authorizations subject to an obligation to make a financial contribution to the compensation fund.

For determining the level of contribution from postal service providers, the Postal Directive stipulates that EU member states shall use transparent and non-discriminatory criteria, such as the proportion of revenues generated by the provision of the universal service (incl. interchangeable services). For new entrants which have not yet achieved any significant market presence, EU member states can apply a "de minimis threshold", e.g. exempting undertakings whose national turnover is less than a set limit. Similarly, the EU member states can define a maximum ceiling on the individual contributions of operators, e.g. set as a percentage of the operator's national annual turnover from the provision of postal services.

Excursus: Uniform rate requirements by Postal Directive

The Postal Directive permits, but does not require, EU member states to adopt uniform rate requirements (charging the same price for delivering a letter across the country as well as across town) for single-piece items. Further, EU member states may also maintain uniform tariffs for other mail items, such as newspapers and books, to protect general public interests, such as access to culture, ensuring participation in a democratic society (freedom of press) or regional and social cohesion.[5]

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3 Profitability cost approach: The net cost of the USO is measured as the difference between a USP's profit level with and without USO in a liberalised market. The 'profitability cost' can also be expressed as the net avoidable costs – given by the sum of the change in incremental costs and the change in revenues.

4 European Commission (2014): Competition policy brief "High quality and competitive postal services for citizens and businesses - State aid control in the postal sector", Issue 6, May 2014.

5 Directive 2008/6/EC, Recital 38.

Most EU member states require a uniform national tariff for basic letter post items and basic parcel post including almost all benchmark countries (except for Germany). Some European countries also require a uniform national tariff for bulk letters. Among the benchmark countries this applies only to Belgium.

2.2 Requirements of State Aid Control

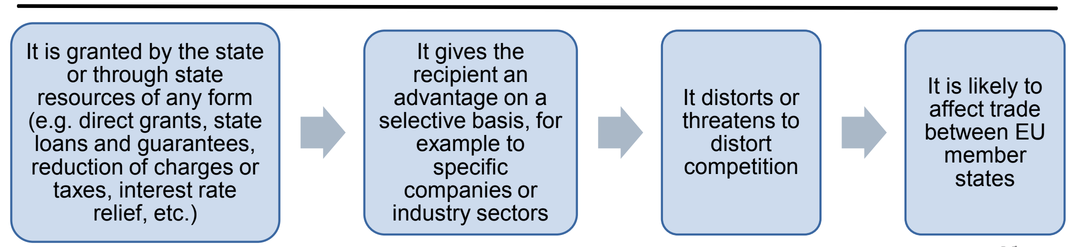
Besides compensation payments from fund solutions some EU member states support their universal postal operator in several other ways, e.g. via direct grants, tax reliefs, contributions to pension costs, guarantees, etc.

The "Treaty on the Functioning of the European Union" (TFEU) generally prohibits state aid unless it is justified by reasons of general economic development. State aid control is carried out by the Directorate-General for Competition of the European Commission.[6]

According to Article 108(3) TFEU (formerly Article 88(3) TEC), the EU member states have to inform the European Commission of any plans to grant or alter any kind of state aid. After application, the Commission has to examine a request within two months. The Commission can take the following decisions: (1) no state aid, (2) state aid, but compatible with the internal market, or (3) opening of a formal investigation procedure. Aid measures can only be implemented after approval by the Commission. Moreover, the Commission has the power to recover incompatible state aid.[7]

According to Article 107(1) TFEU (formerly Article 87(1) TEC) a measure constitutes per se illegal state aid if all of the following four conditions are met.

Figure 1 Criteria for illegal state aid (Art. 107(1) TFEU)



State aid rules apply only to aid that has all four elements set out in Article 107(1).[8] If it does not have all four (e.g. support that a private sector investor would provide under

6 European Commission (2015), Competition Policy in the European Union, http://ec.europa.eu/dgs/competition/index_en.htm.
7 European Commission (2015), What is State Aid?, http://ec.europa.eu/competition/state_aid/overview/index_en.html
8 Please note: If the government is only indirectly involved in the transfer of payments, e.g. as administrator of a compensation fund financed by a special tax on postal operators or their users, the first criteria for an illegal state aid according to Art. 107(1) TFEU is nevertheless fulfilled. Therefore, financing of postal operators through a compensation fund is also subject to state aid control and requires prior notification to the Commission pursuant to Article 108(3) TFEU (see Directive

the same conditions), Article 107(1) does not forbid state aid. Article 107(1) TFEU acts as a general ban, but the TFEU also allows certain aid, e.g.:

- aid categories that the TFEU declares compatible in Art. 107(2) TFEU (e.g. social aid for individual customers and aid for damages of natural disasters),
- aid categories that may be considered compatible in Article 107(3) TFEU (e.g. aid for rescuing and restructuring certain areas of the EU).

Furthermore, the TFEU also leaves room for a number of policy objectives for which state aid can be considered compatible, e.g. for services of general economic interest (SGEI) such as the provision of the universal postal service.[9] A public compensation for SGEI is not an illegal state aid in the meaning of 107(1) TFEU, if it meets the four conditions of the "Altmark case" (see box below)[10].

2002/39/EC of the European Parliament and of the Council of 10 June 2002 amending Directive 97/67/EC with regard to the further opening to competition of Community postal service, OJ L 176, 5.7.2002, Recital 25 and European Commission (2012), Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest, 2012/C 8/02, OJ C8, 11.1.2012, Recital 34).

9 European Commission (2015), What is State Aid?, http://ec.europa.eu/competition/state_aid/overview/index_en.html

10 Case C-280/00, Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH, [2003] ECR I-7744.

However, if a public compensation does not meet the four Altmark conditions, but does not exceed the net cost of providing SGEI (incl. a reasonable profit) and meets the conditions of the Commission 2012 SGEI Framework[11], Article 106(2) TFEU allows the Commission to declare SGEIs compensation compatible with the internal market. The net cost to be taken into account should be calculated as the difference between the net cost of operating the public service obligation and the net cost (or profit) operating without the public service obligation.[12]

Altmark conditions

Public compensation is not an illegal state aid when

1. the recipient undertaking must actually have public service obligations to discharge, and the obligations must be clearly defined;
2. the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner;
3. the compensation must not exceed what is necessary to cover all or part of the costs incurred in the discharge of the public service obligations, taking into account the relevant receipts and a reasonable profit; and
4. where the undertaking that is to discharge public service obligations is not chosen pursuant to a public procurement procedure, the level of compensation needed must be determined on the basis of an analysis of the costs that a typical undertaking, well run and adequately provided with the relevant means, would have incurred.

Source: Case C-280/00, Altmark Ruling.

Please Note: The "de minimis" state aid regulation allows for aid of up to € 200,000 to be provided from public funds to any business enterprise over a rolling three-year period. Such aid is exempted from the requirement of prior notification and approval by the Commission.

11 Official Journal of the EU (2012), Communication from the Commission – European Union framework for State aid in the form of public service compensation (2011), 2012/C8/03, OJ C8, 11.1.2012.

12 Official Journal of the EU (2012), Commission Decision of 20 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest (notified under document C(2011) 9380), 2012/21/EU, OJ L7, 11.1.2012, Article 5.

3 USO funding in Belgium

The Belgian postal market has been fully opened to competition since the beginning of 2011. However, the level of competition is still very low. The incumbent postal operator in Belgium is bpost. TBC Post is currently the only other postal operator on the domestic Belgian letter post market with an estimated market share of less than 1% at the end of 2014.[13]

Belgium is the country in this benchmark with the most extensive scope of services included in the USO. All postal services (excl. unaddressed advertising) are considered as universal postal service (see Table 1).

Table 1 Legal requirements for postal universal service in Belgium

Scope of universal service	Transit time target(s)	Frequency of delivery
National and international services for: • Letters (incl. Direct Mail) up to 2 kg • Registered and insured letters (no weight limit) • Parcels (national) up to 10 kg • Parcel (inbound) up to 20 kg	National letters: 95% (D+1), and 97% (D+2) International letters: 85% (D+3), and 97% (D+5)	5 days per week

Source: Act of 21 March 1991, Art. 142, §§1 and 2, and 5th management contract, Art. 5-6.

In contrast to most other European countries, the Belgian legislation also provides for additional public service missions besides the universal service.[14] The following chart shows the main missions of bpost.

Table 2 Additional public service missions of bpost

Dense postal network (denser than required by USO)
• Obligation to maintain a retail network with at least 1,300 postal service points and 650 post offices (denser than requirement of USO: at least one post office in each of the 589 Belgian municipalities) • Further: postal services points with minimum service range must be accessible by road for a minimum of 95% of the population within 5 kilometers and for a minimum of 98% within 10 kilometers
Service proposed to consumers at a certain frequency (day to day services)
• Delivery of newspapers and periodicals (delivery before 7:30 during the week) • Postal financial services (among others a universal bank account) • Home payment of pensions
Ad hoc services proposed without any recurrence
• The social role of the postman (e.g. passing time with persons who live alone and the least privileged) • Delivery of addressed/unaddressed election printed items at reduced prices • Delivery of items of correspondence sent by non-profit associations at reduced prices • Delivery of postal items that fall within the freepost system originating from certain public authorities • Printing, sale, reimbursement, replacement and exchange of fishing permits

Source: 5th management contract and Act of 21 March 1991, Art. 141 and 144.

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13 WIK-Consult (2015), Review of the postal market three years after full market opening on 1 January 2011, report for BIPT, http://www.bipt.be/public/files/en/21432/wik_BIPT_bilan_postal_EN.pdf

14 Act of 21 March 1991, Art. 141, Royal Decree of 24 April 2014 on postal regulation, Articles 39 to 61, and 5th management contract, Articles 10 to 50.

bpost has been designated by law as the universal service provider until December 2018.[15] After that, it shall be designated according to a tendering procedure for a ten-year period.[16] bpost has also been designated by law as the provider of additional public service missions.[17] These services are dealt within the 5th management contract due to end at the end of 2015. Regarding press distribution, a competitive, transparent, and non-discriminatory tendering procedure has been launched with a view to designate the provider of this service, in principle from January 2016 for a five-year period.[18] The postal market in Belgium is regulated by BIPT (Belgian Institute for Postal Services and Telecommunications).

3.1 Various funding mechanisms in place

In Belgium, the postal legislation does not foresee a compensation fund. Until 2010, postal law in Belgium included the option to establish a compensation fund but this option was diminished in the course of transposition of Directive 2008/6/EC in 2010. Today, the net cost of the universal service as well as the costs for the additional public service missions can be compensated solely by public funds. The government chose direct state subsidization because of the uncertainty present in other financing mechanisms such as compensation funds for which there is a higher chance of legal procedures, and because of direct state subsidization has a neutral impact on the competition.[19]

For the calculation of net costs bpost shall have a cost accounting system which clearly distinguishes between the different services comprised in the universal service, in public service missions and other postal services, and uses the fully distributed costing (FDC) method to which the ABC (activity-based costing) principle is applied.[20]

Universal service compensation

For universal services bpost has first to calculate the net cost of the universal service in accordance with the net avoided cost methodology (as the difference between the existence of universal service obligations and the absence of these obligations) and taking into account all other relevant elements, including any intangible benefits. In a second step the net cost calculation has to be verified by BIPT.[21]

15 Act of 21 March 1991, Art. 144octies, §1, and 5th management contract, Art. 4.
16 Act of 21 March 1991, Art. 144octies, §§ 2-4, and Royal Decree of 11 January 2006.
17 Act of 21 March 1991, Art. 141quinquies.
18 Act of 21 March 1991, Art 141, §1bis. See the call for tenders of BIPT of 9 April 2014 on the service concession for the distribution of recognized newspapers (lot 1) and the distribution of recognized periodicals (lot 2).
19 Interview with BIPT.
20 Act of 21 March 1991, Art. 144quinquies to 144sexies. See the Communication of BIPT Council of 20 February 2014 regarding the compliance statement of the cost accounting system for bpost for 2012.
21 Act of 21 March 1991, Art. 144undecies and Communication of the BIPT Council of 21 May 2014 on the verification of the calculation of the universal postal service net cost in Belgium.

If the net cost of the universal service exceeds 3% of the turnover of the universal service provider in the universal service segment, it constitutes an unfair burden that has to be compensated by the state budget.[22]

Compensations for public service missions

For public service missions of bpost, the net cost has been provisionally assessed by the Belgian state in accordance with the net avoided cost methodology adjusted by a bonus-malus system based on efficiency and quality since 2010.[24] How the amount of compensation is calculated is shown in the box on the left. The compensation mechanism includes incentives for bpost to increase the efficiency and quality of its public service missions by including a share of the gains/losses of efficiency and a quality coefficient that is based on the actual performance of bpost. The share of gains/losses of efficiency has to be calculated as the effective reduction of total costs (or increase in total costs) through the execution of public service missions incurred by bpost, compared with 2010. Gains and losses of efficiency will be shared between the Belgian state (33%) and bpost (67%).[25]

Compensation mechanism for

Compensation payment:

= net avoided cost of bpost (incl. a reasonable profit)

± a share of the gains/losses of efficiency

– a quality coefficient based on the actual performance of bpost[23]

Source: 5th management contract, Art. 22.

This provisional calculation of the net cost is verified ex post by a “College of Commissioners”. The College of Commissioners is composed of four members (Commissioners): The general meeting of shareholders of bpost and the Court of Auditors each have to designate two Commissioners. BIPT is not involved in the whole process. If the prediction turns out to be too generous, the financial compensation will be reduced accordingly.[26]

3.2 Experience with funding mechanisms

In Belgium, the universal service will be funded in case of a net cost. Up to now, there has been no net cost regarding the universal service and therefore no funding. However, the government has a yearly foreseen budget regarding public service missions.[27] As the scope of the public service missions is larger than in most of the EU

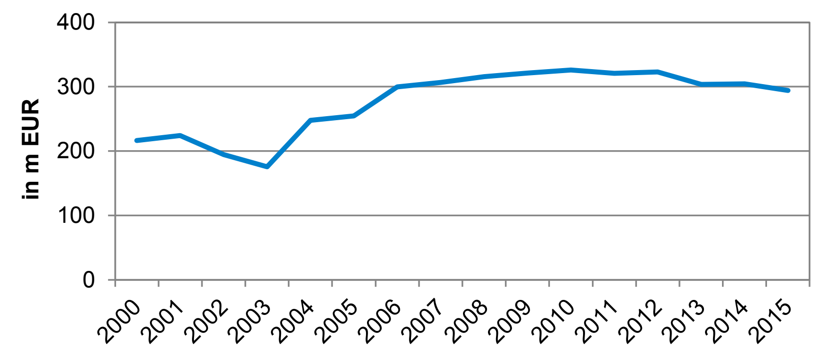
22 Act of 21 March 1991, Art. 144undecies, §2 and Art. 144novies.
23 Based on quality requirements laid down in 5th management contract, Art. 24.
24 Act of 21 March 1991, Art. 141ter, 5th management contract, Art. 22 for the density of the postal network, Art. 28-32 and 35-37 for delivery of press items, Art. 40-43 for financial services, Art. 45-47 for retirement services, Art. 50-51 for the ad hoc services.
25 5th management contract, Art 22.
26 5th management contract, Art. 13.
27 Interview with BIPT.

member states, the financial compensation is also considerably higher than in most European countries.[28]

In 2009, the Commission opened an investigation of all state measures in favor of bpost during the period 1992-2010. The Commission found that yearly compensations, amounting to € 5.2bn between 1992 and 2010, granted to bpost for the delivery of newspapers and magazines partly exceeded the net cost of the services of general economic interest. Therefore, the Commission ordered Belgium in 2012 to recover € 417m of incompatible aid.[29] This decision has been appealed by bpost and by Post Invest Europe.[30] However, the General Court dismissed both actions as inadmissible in 2013.[31]

In March 2013, Belgium notified the Commission of plans to give a yearly compensation of around € 300m to finance public service missions entrusted to bpost by the 5th Management Contract over the period 2013-2015. The European Commission has validated the methodology used to determine the net costs of public service missions and concluded that the compensation does not exceed the costs for fulfilling the services, hence can be exempted under Art. 106(2) TFEU.[32]

Figure 2 Development of compensation payments for public service missions in Belgium (2000-2015)



Source: Decision 2012/321 of the Commission of 25 January 2012, and 5th management contract, Art. 12.

After subsidies for bpost had increased considerably in the 2000s, compensation payments have slightly declined in recent years as a result of efficiency gains. However, they still account for around 12% of the annual turnover of bpost.

28 WIK-Consult (2015), Review of the postal market three years after full market opening on 1 January 2011, report for BIPT, http://www.bipt.be/public/files/en/21432/wik_BIPT_bilan_postal_EN.pdf
29 Decision 2012/321 of the European Commission of 25 January 2012, Mesures en faveur de La Poste belge, OJ L170, 26 Jun 2012.
30 Action brought on 17 September 2012, Case T-412/12 bpost v. Commission, OJ C343, 10 Nov 2012, p. 20 and action brought on 20 September 2012, Case T-413/12 Post Invest Europe v. Commission, OJ C343, 10 Nov 2012, p. 21.
31 Order of the General Court, 15 May 2013, Case T-413/12.
32 Decision 2013/1909 of the European Commission of 2 May 2013, recital 176-178.

3.3 Assessment of how well funding mechanisms have worked

bpost only receives public compensation payments for the provision of their public service missions, not for the provision of the universal service. The option to implement a universal service fund was removed from the postal law.

BIPT assessed the advantages and disadvantages of public compensation payments and a universal service fund as follows: Public funding offers the advantage that net costs are distributed among all tax payers. The disadvantage of public funding is that it colludes with the ‘sender pays’ principle, and could lead to moral hazard by senders due to the fact that they do not bear the total cost of the sent letters. A compensation fund instead would contain the advantage that the public treasury would not be addressed when net costs occur. The disadvantage on the other hand is that these net costs would have to be compensated by the market players, leading to a situation where the incumbent would have to largely finance itself.

The Belgian government chose public funding because of the uncertainty present in other financing mechanisms such as compensation funds (for instance higher chances of legal procedures) and its neutral impact on the competition.[33]

Despite (or because) of the high compensation payments (12% of turnover), bpost is currently one of the most profitable postal operator in Europe (rate of return of around 20%). This raises the question whether the high subsidies are needed at all.

33 Interview with BIPT.

4 USO Funding in France

The French postal market has been fully opened to competition in line with the EC schedule at the beginning of 2011. The universal service comprises letters up to two kilograms, parcels up to 20 kilograms, and newspapers up to two kilograms. It also includes recorded mail and valuable consignments.[34]

Table 3 Legal requirements for postal universal service in France

Scope of universal service	Transit time target(s)	Frequency of delivery
National and international services for: • Letters up to 2 kg • Registered and insured letters up to 2 kg • Parcels up to 20 kg	National: • Letters − Priority: >85% (D+1), >99% (D+3) − Non-Priority: 95% (D+2) • Parcels: 88% (D+2), and 98,5% (D+4) For international items within the EU apply the provisions of the Postal Directive	6 days per week

Source: Code des postes et des communications electroniques of 26 July 2013, Art. L1 and Contrat de plan (2013-2017), p. 10.

Although France's letter market is liberalized, the incumbent postal operator La Poste faces only little competition, mainly in the segment of international letters. La Poste still dominates the national market for letter mail. According to the French postal law of 2010, La Poste is the designated universal service provider in France through 2026. La Poste and the French government agrees on a management contract (Contrat de Plan) to fix their commitments, in particular maintaining the public service missions that have been entrusted to La Poste: Universal Postal Service, Press transportation and delivery, and Regional Planning. A new business contract was signed on 1 July 2013 between La Poste and the French government for the 2013-2017 period. ARCEP supervises the universal service obligation and regulates La Poste.

4.1 Various funding mechanisms in place

In France, the universal service provider La Poste receives two kinds of compensation payments:

- Compensation for lower press tariffs
- Tax relief for providing a dense postal network

Further, the French postal law provides the possibility to establish a universal service fund. However, this fund is still not in force.

34 Code des postes et des communications electroniques of 26 July 2013, Art. L1.

Compensation for lower press tariffs

One public service mission in France entrusted to La Poste is the transportation and delivery of press items (newspapers and magazines).[35] This mission is carried on throughout the national territory under conditions that ensure equal treatment of subscribers at uniform rates with a very high level of quality of service (>97% for daily newspapers). The conditions for support, routing, processing, and distribution of press items by La Poste are agreed upon between the French state, representatives of publishers and La Poste on 23 July 2008 ("l'accord Schwartz") for the period from 1 January 2009 to the end of 2015.[36]

La Poste has to grant reduced tariffs for delivery of press items. The Minister responsible for postal issues approves the tariffs for press items, after public consultation with ARCEP. The French state financially supports the service of transport and distribution of the press by compensating (annual financial contribution) the additional costs of the public service mission entrusted to La Poste. The amount of compensation is contractually fixed within the management contract of La Poste and the French government.[37] The fee structure of these services must promote pluralism, notably that of political and general information.[38]

Tax relief for providing a dense postal network

Article 6 of the Law of 2 July 1990 described the scope of the public service mission entrusted to La Poste to ensure a dense postal network (in addition to universal service requirements): 90% of the population of each department should reach a post office in no more than 5 kilometers and no more than twenty minutes by car. The French postal law requires a minimum number of 17,000 post offices at national level.[39]

Further, La Poste agrees on a multi-annual postal coverage contract with the French State and an association of the most representative national mayors.[40] ARCEP has to evaluate the net cost of these additional territorial network requirements of La Poste. La Poste is granted a tax relief to fund its dense postal network. The amount of allowances is fixed each year by decree, in line with the forecast of the amount of funds contained in the postal coverage contract, and provided that this amount does not exceed the net cost of additional mesh as assessed by ARCEP.

In each department, a Commission of the postal territorial presence (Commission Départementale de la Présence Postale Territoriale), composed of local elected officials, representatives of La Poste and the State monitors compliance with the

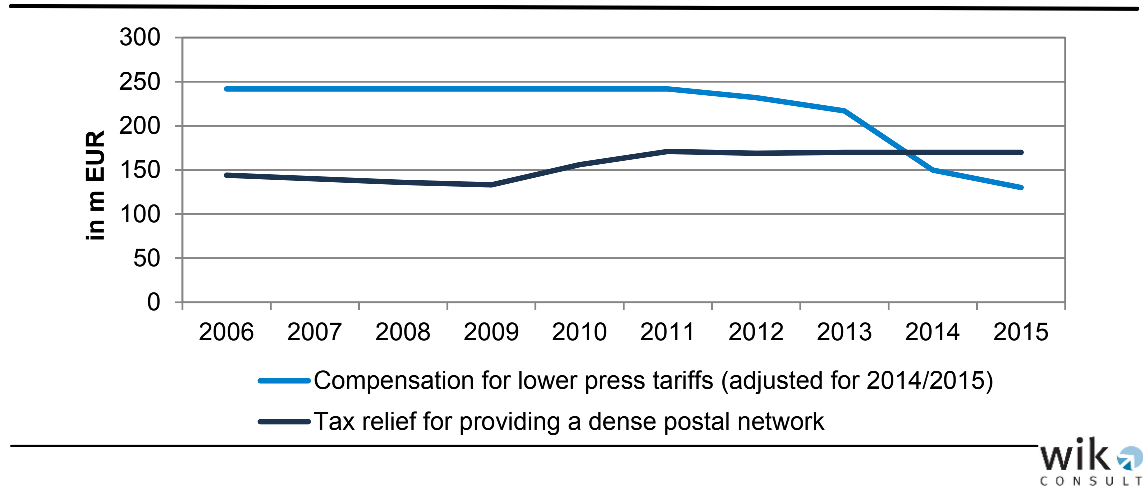
35 Confirmed by the French Postal Act of 9 February 2010.
36 Contrat de plan (2013-2017), p. 11.
37 Contrat de plan (2013-2017), p. 11.
38 Code des postes et des communications electroniques of 26 July 2013, Art. L4.
39 Contrat de plan (2013-2017), p. 17.
40 The current contract was signed on 26 January 2011.

territorial accessibility standard, and gives its opinion on the annual report of the postal network accessibility. This report specifies the positioning of the contact points of La Poste within priority areas (sensitive urban areas, rural development zones and mountain areas).

4.2 Experience with funding mechanisms

La Poste receives two types of public grants: A compensation for lower press tariffs and a tax relief for providing a dense postal network. The recent history of both compensation payments is shown in Figure 3.

Figure 3 Development of compensations for lower press tariffs and a tax relief for providing a dense postal network in France (2006-2015)



Source: Contrat de plan (2013-2017), Contrat de plan (2008-2012), and Contrat de plan (2003-2007).

Compensation for lower press tariffs

La Poste receives compensations for lower press tariffs of € 242m per year between 2005 and 2011. The compensation payments have decreased in recent years. The French government recently reduced the compensation by € 50m for 2014 and 2015 (to € 150m resp. € 130m, see Figure 3) due to budget constraints for the state. The "Schwartz" agreement expires at the end of 2015 and it is still not clear what will happen after that. It has also been discussed, inter alia, to substitute the compensation paid to La Poste by a direct payment to the French publishers.

The evolution of press rates takes into account the specificity of each news category. The overall evolution over the past seven years has been slightly below 11% for daily press publications with low advertising resources and 25% for press items with political and general information. It has been close to 34% for the rest of the press.[41]

The compensation payments for lower press tariffs were the subject of an investigation by the European Commission in 2012. The Commission decided to approve the aid.[42]

Tax relief for providing a dense postal network

The net cost of La Poste for ensuring a dense postal network has been estimated by ARCEP at € 269m for 2010 and € 247m for 2011.[43] However, the tax relief for La Poste amounts to around € 170m. In contrast to compensation payments for lower press tariffs, the tax relief for ensuring a dense postal network has continuously increased in recent years.

The European Commission has approved the tax relief granted by France to La Poste for the purpose of maintaining a high density of postal services over the period 2008-2012. The Commission concluded that tax relief is compatible with EU state-aid rules because it only partially offsets the net costs of the important public service tasks.[44]

4.3 Assessment of how well funding mechanisms have worked

La Poste receives a tax relief for providing a dense postal network. In France, the post office network has an important social and economic role for the citizens. Therefore, the French government granted around € 170m per year. Furthermore, for lower press tariffs, La Poste receives a compensation of around € 180m per year. Both aids together, account for more than 2% of La Poste's total revenues. However, the share of subsidies on the total turnover of the incumbent is significantly lower in France than in Belgium.

41 To these will be added increases in the consumer price index of around 2.5%.
42 Decision of the Commission of 25 January 2012, Case SA 34 027 – Abattement fiscale en faveur de La Poste pour le financement de la presence territorial.
43 Contrat de plan (2013-2017), p. 17.
44 Decision of the Commission of 25 January 2012, Case SA 34 027 – Abattement fiscale en faveur de La Poste pour le financement de la presence territorial.

5 USO funding in Germany

In Germany, the letter post market has been completely opened to competition since January 2008.[45] Before, competitors of Deutsche Post were allowed to deliver letters up to 50g with higher quality than universal services, e.g. with same-day delivery or tracking and tracing.[46] Since 1998, the universal service in Germany comprises letters, parcels, and publications as the next table shows.[47]

Table 4 Legal requirements for postal universal service in Germany

Scope of universal service	Transit time target(s)	Frequency of delivery
National and international services for: • Letters up to 2 kg • Registered and insured letters up to 2 kg • Letters with cash on delivery up to 2 kg • Letters with expedited delivery up to 2 kg • Parcels up to 20 kg • Newspapers and periodicals	National: • Letters: 80% (D+1), and 95% (D+2) • Parcels (D+2): 80% For international items within the EU the provisions of the Postal Directive apply	6 days per week

Source: Post-Universaldienstleistungsverordnung (Postal universal service ordinance), § 1, 2 and 3 from 15. December 1999.

At present, Germany is the only European country where there is no obligated universal service provider since full market opening. Rather, the market as a whole is expected to provide the universal service in Germany. In practice, the services voluntarily offered by Deutsche Post alone already fulfil the legal requirements for universal service.

Development of competition in Germany was considerably influenced by liberalization of low-weight items with higher quality than universal services. A large number of competitors used this exemption from the reserved area to build up local delivery networks. Their market share developed gradually and reached approximately 12% of market volume in 2014. Currently, the biggest competitor in Germany is Postcon, with an estimated market share of about 8%.[48] The German postal market is regulated by Bundesnetzagentur (BNetzA).

45 Note that the 1998 German postal law had determined the postal monopoly to end by the end of 2002. The law was changed in 2001 to extend the reserved area until 2007, and phase out the monopoly more gradually, more in line with the schedule of the EU postal directive.

46 Further exemptions from the reserved area included document exchange, collection of letters from post box facilities of the USP and delivery to the recipient as well as collection of letters at the sender and deposit at facilities of Deutsche Post.

47 Post-Universaldienstleistungsverordnung (Postal universal service ordinance), §1, from 15. December 1999.

48 Post and Parcel (2015), PostCon to restructure headquarters with loss of 140 jobs, article from 1. April 2015.

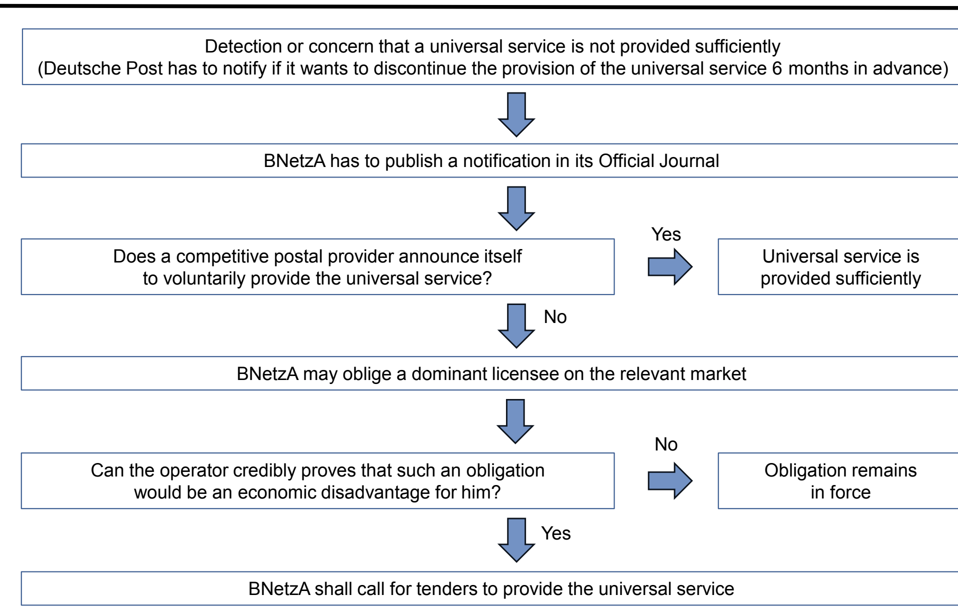
5.1 Various funding mechanisms in place

In Germany, the universal service is currently voluntarily provided and financed by Deutsche Post. However, Deutsche Post benefits from the relief of excessive pension costs of civil servants. Further, German postal law allows installing a universal service fund for financing a (potential) universal service obligation.

Universal service fund

Currently, the universal service is voluntarily provided by Deutsche Post. If Deutsche Post intends to discontinue the provision of the universal service or to provide such services on less favorable terms than specified in the postal act, it has to notify BNetzA six months prior to cutting down the universal service. If the universal service is not being adequately provided or if there is reason to believe that such will be the case in the near future, BNetzA can oblige an operator to provide the universal service or can call for tenders to provide the universal service gap. The German Postal Act provides a clear mechanism by which BNetzA has to ensure the provision of the universal service. The process is illustrated in Figure 4.

Figure 4 Process upon discovery of a universal service deficit in Germany



Source: Postgesetz (postal law), §§ 13, 14 and 56.

The German Postal Act grants the BNetzA the authority to determine the subject of the public procurement and the tendering procedures. BNetzA has to define in detail the subject of the tender, the area in question and the criteria for assessing the necessary performance, reliability and expertise of the bidders.[49]

In a subsequent public procurement the universal service has to be assigned to the operator demanding the least financial compensation. The compensation for providing the tendered universal services would be financed by a universal service fund. Each licensed operator on the German letter post market (including Deutsche Post) with revenue greater than € 500,000 during the last calendar year would have to contribute to this fund. The contribution would be calculated according to the share of each license holder's revenues to the revenues of all license holders.[50]

Relief of pension costs of civil servants

Since the first postal reform in 1989 Deutsche Post has to fund the full amount of the pension payments and health care costs for its retired civil servants. In 1994, the payment of pensions and health benefits to retired civil servants was taken over by a newly created pension fund for civil servants of Deutsche Post.

Between 1995 and 1999 Deutsche Post had to pay an annual contribution of € 2.045bn (€ 10.225bn in total) to the pension fund. However, Deutsche Post also receives substantial subsidies since 1995 for the pension costs of its civil servants. Since 2000, the annual contribution of Deutsche Post to the pension fund was lowered to 33% of the incurred civil servants' salaries (i.e. contributions of € 735m in 2000 up to € 540m in 2010).[51]

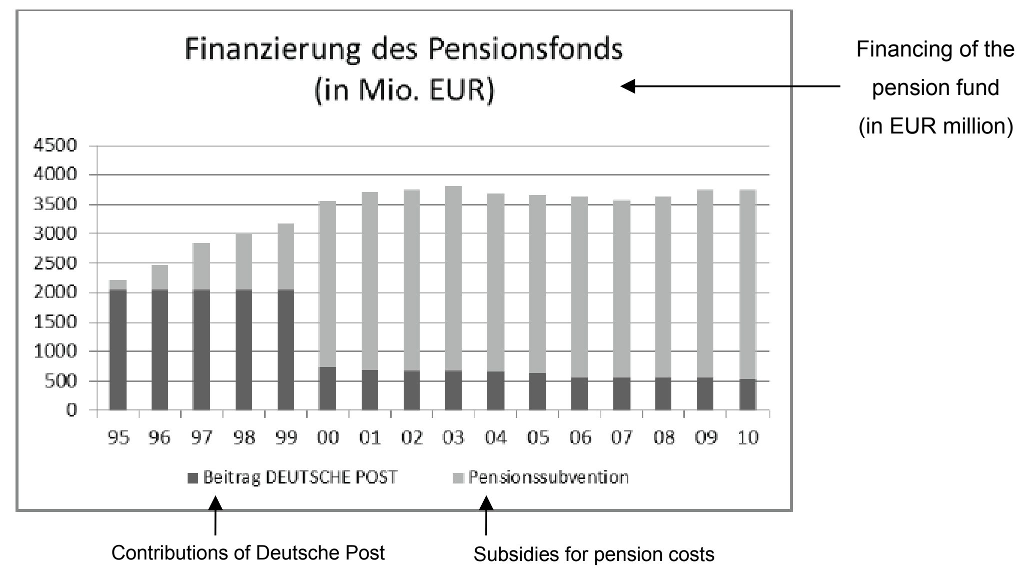
5.2 Experience with funding mechanisms

Since German postal law came into force in 1998, the regulator has not observed any universal service deficits and the universal service fund has not been put into place.

The universal postal service is financed by the revenues generated by Deutsche Post DHL. Further, Deutsche Post receives substantial subsidies for pension costs that were already subject of detailed investigations by the European Commission. The Commission figured out that the pension subsidy had increased from € 151m in 1995 to € 3.2bn in 2010 and amounted to a total of around € 37bn for the period 1995-2010.[52]

49 Postgesetz (German postal law), § 14 (4).
50 Postgesetz (German postal law), § 12 (1) and § 15.
51 PostPersRG § 16 para 1.
52 Decision 2012/636 of the Commission of 25 January 2012, Complaint against Germany for unlawful state aid to Deutsche Post, OJ L289, 19 Oct 2012.

Figure 5 Breakdown of financing pension costs of Deutsche Post's civil servants



Source: Decision 2012/636 of the European Commission against Germany for unlawful state aid to Deutsche Post, p. 13.

In January 2012,[53] the Commission concluded that Deutsche Post had effectively borne significantly lower social contributions (between 10 and 14% lower) due to pension subsidies than its private competitors for services which were open to competition (e.g. parcel services). The Commission ordered to pay back subsidies for pension costs in the range of € 500m to € 1bn it had received from 2003 onwards. In March/April 2012, the German government[54] and Deutsche Post[55] appealed the Commission's decision for several reasons: among others, incorrect classification of public compensation as aid, improper treatment of the regulated charges imposed by the German regulator, incorrect benchmarking for the social security charges paid by private competitors, contradiction in the decision, and length of the procedure. Both actions brought are still pending.

In May 2012, the German government evaluated the amount of the recovery on the basis of the Commission criteria and ended up with an amount of € 298m, which was below the lower limit indicated by the Commission. Deutsche Post has paid the € 298m on June 2012 to an escrow account (in consultation with the Federal Government). The Commission did not agree with the calculation of aid recovery of the German government and brought an action against Germany at the European Court of Justice

53 Decision 2012/636 of the Commission of 25 January 2012, *Complaint against Germany for unlawful state aid to Deutsche Post,* OJ L289, 19 Oct 2012.
54 Action brought on 30 March 2012, T-143/12 *Germany v Commission*, OJ C165, 9 Jun 2012, p. 27.
55 Action brought on 4 April 2012, Case T-152/12 *Deutsche Post v Commission*, OJ C165, 9 June 2012, p. 30.

(ECJ) in December 2013 in order to obtain a higher reimbursement.[56] The ECJ decided in May 2015 that the German government has only insufficiently implemented its decision since it has inadequately examined whether the B2B parcel service is a rate-regulated service.[57] However, the German government has not immediately reclaimed additional pension payments, since the actions of the German government and Deutsche Post against the Commission's decision are still pending.

5.3 Assessment of how well funding mechanisms have worked

Currently, the universal service is voluntarily provided and financed by Deutsche Post. BNetzA believes that Deutsche Post will voluntarily provide the universal service in the coming years too. The reasons are quite simple: If Deutsche Post would discontinue the provision of the full range of the universal service it would suffer damage to its image that would most likely be lower than their expected cost savings. Further, Deutsche Post would probably lose its exemption from VAT.[58]

However, if there is an insufficient supply of the universal postal service, the BNetzA would limit the tender subject to small or regionally limited universal service gaps.[59] Though, an invitation to tender would be associated with many further questions, such as the formulation of the tender subject and questions of network interconnection between Deutsche Post and the successful bidder. While BNetzA also recognizes the benefits of a public procurement (such as the reduction of costs for the provision of the universal service gap and promoting competition), it assumes that the public procurement mechanism will never be used in practice.[60]

In BNetzA's view, the application of the universal service fund could cause a high administrative burden. Furthermore, due to the rules of the universal service fund, the incumbent would have to largely finance the universal service, regardless of by whom it is provided.[61] In addition, the obligation to contribute to a universal service fund could distort competition in the postal market. Moreover, it is unclear whether the fund would collect enough money to finance the universal service gap.

56 Action brought on 17 December 2013, C-674/13 European Commission v Federal Republic of Germany, OJ C45, 15 Feb 2014, p. 26.
57 Decision of the ECJ C-674/13 of 6 May 2015.
58 Interview with BNetzA. Please note: The VAT exemption of Deutsche Post is not a form of USO compensation (and therefore not mentioned on the previous pages), but it's a benefit included in the USO costing approach.
59 Interview with BNetzA.
60 Interview with BNetzA.
61 Interview with BNetzA.

6 USO funding in Italy

The Postal Directive 2008/6/EC was implemented in Italy by Legislative Decree 58/2011.[62] Since 30 April 2011, the Italian postal market is fully liberalized and the reserved area has been eliminated, except for a minor share of volumes related to legal process and notification of violations of the Italian Highway Code.[63] The scope of the universal service is shown in the next table. It was redefined in 2011 by Decree 58.[64]

Table 5 Legal requirements for postal universal service in Italy

Scope of universal service	Transit time target(s)	Frequency of delivery[65]
National and international services for: • Letters up to 2 kg • Registered and insured letters up to 2 kg • Parcels up to 20 kg Direct Mail for advertising purposes was excluded from universal service, as of 1 June 2012.	National: • Letters − Priority: 89% (D+1), 98% (D+3) − Registered: 92,5% (D+3), 98% (D+5) − Bulk Mail: 94% (D+3), 98% (D+5) • Parcels (D+3): 94% For international items within the EU the provisions of the Postal Directive apply	5 days per week Exception: 3-day-delivery in areas with a population density <200 inhabitants per km up to a maximum of 1/4 of the national population

Source: Decreto Legislativo (Legislative Decree) of 31 March 2011, n. 58, art. 3, Contratto di Programma 2009-2011, and law of 23 December 2014, n. 190, art. 1, para. 276.

In the Italian postal market, only two other major competitors are active in addition to the incumbent postal operator Poste Italiane: Nexive,[66] a subsidiary of the Dutch incumbent operator PostNL, and Sailpost,[67] a consolidated brand with a national franchising network in Italy, owned by Citypost S.p.A. While Sailpost provides letter, parcel and IT services, Nexive is focused on value added services (e.g. recorded delivery), direct mail, and services along the entire value chain. Neither is active in the whole territory, but only in certain areas of Italy. In 2011, the obligation of Poste Italiane to provide universal service was renewed for 15 years (until the end of 2026) by the Ministry of Economy and Finance.[68]

In 2011, the responsibility for the regulation and supervision of the postal sector was transferred from the Ministry for Economic Development to the communications industry regulator AGCom (the Autorità per le Garanzie nelle Comunicazioni).[69]

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62 Legislative Decree 58 of 31 March 2011 relating to "Implementation of Directive 2008/6/EC, which amends Directive 97/67/EC, with regard to the full accomplishment of the internal market of Community postal services", in force since 30 April 2011.
63 Poste Italiane Group (2013), Investor Presentation, June 2013, p. 19, and AGCom (2015), Servizio universal, at the Homepage of AGCom, http://www.agcom.it/servizio-universale-postale
64 Legislative Decree 58 of 31 March 2011, art. 3.
65 The exception has been extended from 1/8 to 1/4 of the national population in 2014.
66 Homepage Nexive: http://www.nexive.it/
67 Homepage SailPost: http://www.sailpost.it/
68 Legislative Decree 58 of 31 March 2011, art. 23 para. 2.
69 Legislative Decree 58 of 31 March 2011, and law 214 of 22 December 2011.

6.1 Various funding mechanisms in place

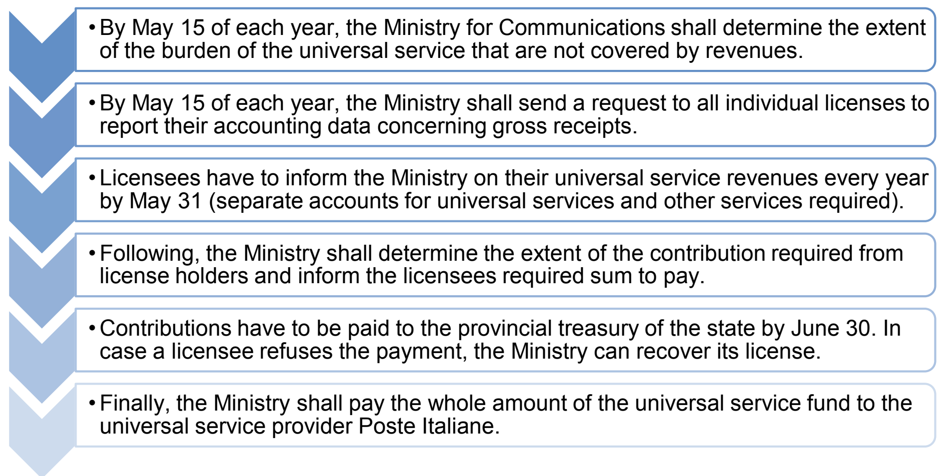
The postal universal service in Italy is financed by a variety of sources (besides the revenues generated by Poste Italiane SpA for providing postal services):[70]

- Universal service fund
- Government subsidies for the provision of the USO
- Government subsidies for reduced-rate tariffs

Universal service fund

Italy was one of the first countries (and the only one in this benchmark) that has already established a universal service fund. Art. 10 of the Legislative Decree 261/1999 required that the fund be based on all licensed postal service providers, but not Poste Italiane.[71] The compensation fund is administered by the Ministry of Communications.[72] A Ministerial Decree[73] provides the criteria for the functioning of the universal service fund, as shown in Figure 6.

Figure 6 Criteria for the functioning of the universal service fund in Italy



Source: Decree of the Minister of Communications of 17 November 2000.

70 Legislative Decree 58 of 31 March 2011, art. 3 para. 12 and Comandini, Vincenso Visco and Mazzarella Francesca (2011), Competition and regulation in the Italian postal market, in: Crew, Michael A. and Kleindorfer, Paul R., Reinventing the postal sector in an electronic age, p. 281-291.
71 Legislative Decree No. 261 of 22 July 1999 on the "Implementation of Directive 97/67/EC on common rules for the development of the internal market of Community postal services and the improvement of quality of service", art.10, para 2, and Interview with Poste Italiane.
72 Legislative Decree No. 261 of 22 July 1999, art.10, para. 1, and interview with Poste Italiane.
73 Ministerial decree of 17 November 2000 regarding the mode of operation of a fund to offset the costs of the universal postal service of the Minister of Communications in conjunction with the Minister of the Treasury, Budget and Economic Planning.

The rate of contribution to the compensation fund is fixed yearly by the regulatory authority. Art. 10 of the Legislative Decree 261/1999 set the upper limit of the contribution at a maximum of 10% of the licensees' gross revenues from the letter segment.[74] Until now, the Ministry has always set the percentage at 3%, significantly below the maximum allowed.[75]

Government subsidies for the provision of the USO

The "Contratto di Programma 2009-2011" regulates the relationship between the Ministry for Economic Development and Poste Italiane in connection with the Universal Postal Service. It defines public compensations for Poste Italiane and will remain in force pursuant to Law 190/2014 until completion of the approval procedure regarding the new planning agreement for the five-year period 2015-2019. The new planning agreement is expected to be signed in August/September.[76]

USO Subsidy Cap mechanism

Formula: $S_n = S_{n-1}(p_n^* - y_n)$

S_n = compensation for the year n

S_{n-1} = compensation for the previous year

p_n^* = planned rate of inflation for the year n

y_n = planned efficiency gain in year n

Source: Contratto di Programma 2009-2011, Art. 9.

Public grants for Poste Italiane were calculated on the basis of a subsidy cap mechanism (see box on the left).[77] The amount of the subsidy depends on the subsidy payments of the previous year, the expected inflation rate, and efficiency gains that Poste Italiane has committed to achieve (currently y_n = 3.52%).[78]

Government subsidies for reduced-rate tariffs

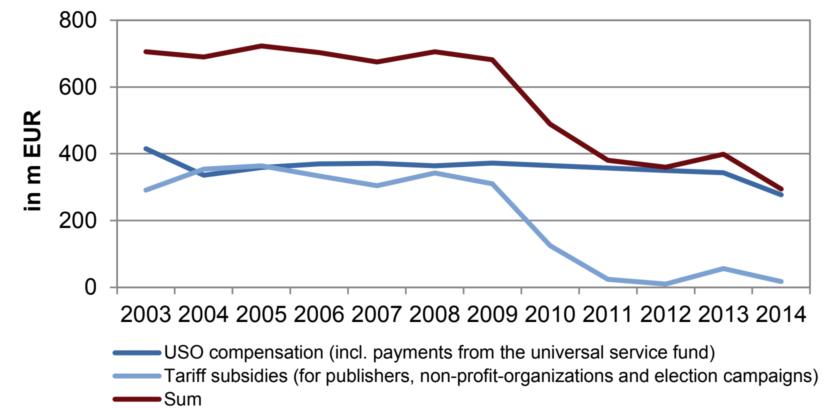
The Italian government grants tariff subsidies for reduced-rate tariffs for certain sectors (publishers, non-profit organizations and election campaign material) to Poste Italiane. Subsidies for lower tariffs for publishers were granted to Poste Italiane for several years. Since 1 April 2010, subsidized tariffs for publishers were abolished.[79] Subsidies for lower tariffs for electoral publicity are established in Art. 17 of Law 515/1993. However, since June 2014, subsidized tariffs for electoral publicity are abolished by Law Decree 66/2014.[80]

74 Legislative Decree No. 261 of 22 July 1999, art. 10, para. 2.
75 See for example Decree of the director for the regulation of the postal sector of 4 July 2012, "Fund to offset the costs of the universal postal service - Financial year 2011", art. 1.
76 Law 190 of 23 December 2014, Art. 1, para. 274 a) and 275, and interview with poste Italiane.
77 Contratto di Programma 2009-2011, art. 9.
78 y_n is the X-factor which sets a target for the productivity of Poste Italiane.
79 Poste Italiane (2011), Annual Report 2010, p. 39.
80 Law 515 of 10 December 1993, art. 17, and law 66 of 1 June 2014, art. 18, and interview with Poste Italiane.

6.2 Experience with funding mechanisms

Although the universal service fund is formally in force, it does not bring any real contribution in practice. However, Poste Italiane receives significant financial support via subsidies for the USO and subsidies for reduced-rate tariffs for certain sectors, as Figure 7 shows.

Figure 7 Development of USO and tariff subsidies in Italy (2003-2014)



Source: Annual Reports of Poste Italiane (2004-2014).

Universal service fund

According to information provided by Poste Italiane, compensation payments from licensed postal operators collected via the fund between 2000 and 2010 only accounted for 0.01% of the USO net cost.[81] For instance, the compensation fund contribution of other operators only amounted to € 111,000 in 2005 (0.04% of USO net cost). And over time, the funds coming from the compensation fund have fallen relative to the total cost of the USO. The contributions to the compensation fund have been considered insufficient to cover the USO burden. The state has to intervene and provide significant subsidies to Poste Italiane.[82]

USO subsidies

Poste Italiane receives significant subsidies (around € 370m per year) for the provision of the USO from state budget. The European Commission has assessed the USO compensation payments for Poste Italiane three times (for the years 2000-2005, 2006-

81 Fratini, Alessandra (2015), Compensation funds under EU law: a suitable solution in the postal market?, paper presented at the 23. Conference on Postal and Delivery Economics, Vouliagmeni Athens, Greece, 6. June 2015.

82 See Figure 3 and Annual Reports of Poste Italiane.

2008, and 2009-2011).[83] In all three investigations, the Commission concluded that the aid was compatible with the internal market pursuant to Article 106(2) TFEU due to the net costs of the universal service obligation significantly exceeding the USO compensation payment. For example, in 2010, the net cost of the USO amounted to € 689m while the yearly compensation amounted to € 364.5m.[84]

In 2014, AGCom verified the net cost of the universal postal service of the years 2011 (€ 380.6m) and 2012 (€ 327.3m) for the first time and reviewed the applicability of the mechanism to allocate the burden of the universal service. Poste Italiane had calculated the burden of the universal service at € 709m and € 704m. The USO compensation covers only around 50% of the net costs.

Also for 2013, AGCom has begun a new preliminary investigation to quantify the burden of the universal postal service.[85] The cost incurred by Poste Italiane was calculated using the new "net avoided cost" method.[86] However, for the coming five-year period (2015-2019), the 2015 Stability Law has set government subsidies for the USO at a maximum of € 262.4m per year effective in 2015, without prejudice to the results of AGCom's assessment.[87]

Tariff subsidies

The Italian government grants Poste Italiane tariff subsidies for reduced-rate tariffs of around € 350m until 2009. Since 2010, tariff subsidies decreased significantly due to major new regulations abolishing subsidized tariffs for publishers.[88] In 2012, the European Commission assessed the tariff subsidies granted to Poste Italiane between 2009 and 2011 under its Framework on SGEI. The Commission found that the tariff subsidies were compatible with EU state aid rules, as the extra costs of the reduced tariffs correspond exactly to the financial support granted to Poste Italiane.[89] Nevertheless, electoral subsidies have been suspended by the Italian state since June 2014.[90]

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83 European Commission decisions C(2006) 4206 def. of 26.9.2006, C(2008) 1606 fin of 30.4.2008, and C(2012) 8230 final of 20.11.2012.
84 European Commission decision C(2012) 8230 final of 20.11.2012, para. 115.
85 See Resolution no. 412/14/CONS and 493/14/CONS of AGCOM.
86 Introduced by EU Directive 2008/6/EC and transposed into Italian law by Legislative Decree 58 of 31 March 2011. The net costs will be calculated "as the difference between the net operating costs of a designated service provider subject to universal service obligations and net operating costs without such obligations."
87 Law 190 of 23 December 2014, Art. 1, para. 274 b).
88 Poste Italiane (2011), Annual Report 2010, p. 39.
89 European Commission decision C(2012) 8230 final of 20.11.2012.
90 Law 66 of 1 June 2014, art. 18.

6.3 Assessment of how well funding mechanisms have worked

In Italy, the USO is mainly financed by state subsidies. However, funds from the government only account for around 40% to 50% of the universal service burden calculated by Poste Italiane.

It raises the question of whether Poste Italiane provides excessive claims or whether the state limits its grants in times of a difficult budgetary situation of the Italian state. Possibly both are true. Effective in 2015, the new Italian stability law has set the government subsidies for the provision of the USO at a maximum of € 262.4m per year. Against this background, the complex calculation of the net costs of the USO by AGCom becomes almost redundant.

The same applies to the universal service fund. The operation of the fund absorbs much administrative efforts of the regulator. Furthermore, the Italian authorities reported difficulties in collecting the contributions from the operators. Only less than 1% of the USO net costs were collected via the fund. Therefore, the compensation fund is absolutely not sufficient in Italy.

7 USO funding in Spain

Since January 2011, the Spanish postal market is completely open to competition. The scope of the universal service is limited to letters and postcards up to 2 kg, parcels up to 20 kg, and registered and insured items (see Table 6). Optionally, addressed direct mail, books, catalogues and periodicals may be included in the universal service by decree. Currently, these services are not part of the universal service.[91]

Table 6 Legal requirements for postal universal service in Spain

Scope of universal service	Transit time target(s)	Frequency of delivery
National and international: • letters and postcards up to 2 kg • parcels up to 20 kg • registered and insured items.	National: • Letters: 93% (D+3), 99% (D+5) • Parcels: 80% (D+3), 95% (D+5) For international items within the EU the provisions of the Postal Directive apply	5 days per week. Exemptions from delivery to the door are permitted by law.

Source: Ley 43/2010 (Postal Law), of 30 December 2010, Art. 21 and 23, and Real Decreto 503/2007 (Royal Decree), of 9 May 2007, Art. 45.

The Spanish incumbent postal operator Correos is mandated to provide the universal postal service until the end of 2026.[92] Competitors in Spain focus on delivery of transaction mail and direct mail in larger cities. That may be explained by the former definition of the reserved area which never included intra-city mail. The biggest competitor is Unipost with a market share of around 12%. All other competitive operators are very small enterprises delivering local mail.[93]

Since 2013, the Spanish postal market is regulated by the Comisión Nacional de los Mercados y la Competencia (CNMC). Further, the Department of Postal Regime of the Ministry of Development (Ministerio de Fomento) retains some duties, e.g. to manage the licensing system (incl. fee collection and keeping the register of postal companies), and the proposal to set the minimum universal service standards.[94]

7.1 Various funding mechanisms in place

In Spain, the universal service provider Correos receives financial support from compensations for the provision of the UPS and further subsidies for staff training and capital subsidies. Further, the Spanish postal law established a dedicated universal service fund in 2011. However, this fund is still not in force.

91 Ley 43/2010 (Postal Law), of 30 December 2010, Art. 21.
92 Law 43/2010, of December 30, first additional provision (Disposición adicional primera).
93 CNSP (2013), Estudio de mercado del sector postal en españa en el año 2011, p. 56.
94 See Homepage of the Ministry de Fomento, Subdirección General de Régimen Postal: http://www.fomento.gob.es/MFOM/LANG_CASTELLANO/DIRECCIONES_GENERALES/SERVICIOS_POSTALES/presentacion.htm

State compensations for the provision of the universal service

Correos is obliged to keep an accounting system that allows it to clearly distinguish between universal postal services and other services and products that are not part of it. Further, Correos has to keep separate accounts for each of the services included in the scope of the universal postal service.[95]

CNMC has to verify the net costs of the Universal Postal Service. Therefore, Correos shall submit the net cost calculation for each year to CNMC. The net cost of the universal service obligation is calculated as the difference between the net cost of Correos operating with public service obligations and if it operated without those obligations. The calculation shall also take into account guarantees and intangible benefits.[96] Subsequently, CNMC shall determine the amount of the unfair financial burden of the universal service obligation for Correos.[97] The ministry notifies the calculated net costs of the universal service and pays this amount to Correos.

Further subsidies

Correos receives further subsidies; first for staff training and second a capital contribution included in the Spanish national budget, used to finance part of Correos acquisitions of assets.

Universal service fund

In 2011, the Spanish postal law established a universal service fund that will be managed by the CNMC. Therefore, a "Plan de Prestacion del servicio postal universal" should include a more detailed regulation of the universal service fund. However this plan has not yet been passed by the ministry.[98] Although the universal service fund is not yet in force, its methodology is already defined. The universal service fund should be financed from various financial sources (see box on the left side).

Universal service fund

The fund will be financed by the:

- budget assigned by the Central Government in its National Budget,
- annual postal contribution of the bearers of individual licenses,
- annual postal contribution of the bearers of individual licenses,
- fees for granting a license, and
- interest on money contained in the fund.

Source: Ley 43/2010 (Postal Law), of 30 December 2010, Art. 29, para. 1 and Art. 30 to 32 for further information.

Under the terms of the law, postal operators with an individual license and an annual revenue from products within the universal service area above 50,000 euros will have to contribute 0.5% of their net revenues to the fund. Therefore, individual licensees providing universal services have to separate

95 Ley 43/2010 (Postal Law), of 30 December 2010, Art. 26, para. 1.
96 Ley 43/2010 (Postal Law), of 30 December 2010, Art. 27.
97 Ley 43/2010 (Postal Law), of 30 December 2010, Art. 28.
98 Ley 43/2010 (Postal Law), of 30 December 2010, Art. 22 (3) and interview with CNMC.

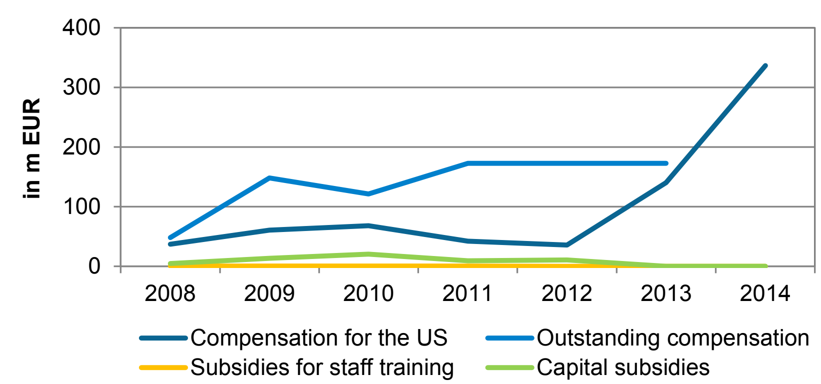
accounts of revenues to differentiate between revenues from the provision of universal services and the income earned by the provision of other services. The operators are obliged to audit their annual accounts.[99] The contribution is payable at the end of the following year. Otherwise, the operator risks the withdrawal of its license. Correos is exempted from this special tax.[100] In addition, every postal operator has to pay a license fee in the amount of € 1,500 that also contributes to the fund.[101] CNMC has to keep a record of income and expenditures of all operators contributing to the fund.[102]

Each quarter Correos will receive a payment from the universal service fund which is based on what emerges from the annual settlement of the financial burden. After determining the net cost and unfair financial burden for the relevant year, CNMC has to pay the difference amount to Correos (or Correos has to reimburse the overcompensation to the fund).[103] However, if the contents of that fund are not sufficient to offset the cost of providing universal service, the Spanish government will fill the gap.[104]

7.2 Experience with funding mechanisms

Although the Spanish postal law provides for a universal service fund, the net costs of the USO are financed by compensation payments from the state. Correos further receives capital subsidies and subsidies for staff training as Figure 8 shows.

Figure 8 Development of state compensations for the provision of the universal service and further subsidies in Spain (2008-2014)



Source: Annual Reports of Correos (2008-2014).
Note: Outstanding compensation payments are attributed to the years they were charged for, not to years they were paid. So far, outstanding compensation payments were calculated and paid only until 2013. There is no data for 2014.

99 Ley 19/1988, of July 12, and Ley 43/2010 (Postal Law), of 30 December 2010, Art. 26, para 4.
100 Ley 43/2010 (Postal Law), of 30 December 2010, Art. 31.
101 Ley 43/2010 (Postal Law), of 30 December 2010, Art. 32.
102 Ley 43/2010 (Postal Law), of 30 December 2010, Art. 29, para 1.
103 Ley 43/2010 (Postal Law), of 30 December 2010, Art. 29, para. 2.
104 Ley 43/2010 (Postal Law), of 30 December 2010, Art. 29, para. 1.

State compensation for the provision of the universal service

In practice, the amount of compensation for the USO was forecasted in Spain, based on the calculation of net costs of the last years. Therefore, Correos receives compensation payments for universal service already in advance. Only after completion of the relevant year the real net costs of the USO were calculated. Correos then receives an outstanding compensation payment (amount between the advance payment and the real compensation level). However, the calculation of real compensation and the disbursement of the outstanding compensation take some time. For instance in 2013, Correos received outstanding compensation payments for the years 2009 (€ 148m) and 2010 (€ 121m). Further, Correos received € 518m outstanding compensation payments for a three-year-period (2011-2013) in 2014.[105]

As Figure 8 shows, advanced compensation payments have increased excessively in the last few years. While the compensation payments were still around € 40m in 2011 and 2012, they have skyrocketed to € 140m in 2013 and € 337m in 2014.[106]

Further subsidies

Since 2008, Correos receives subsidies for staff training. These payments are declining constantly from € 627,000 in 2008 to € 171,000 in 2014.[107] Further, Correos received capital subsidies until 2012. Since 2013, these payments are still pending. Capital subsidies have fluctuated between € 5m and € 20m per year since 2008.[108]

7.3 Assessment of how well funding mechanisms have worked

Correos receives substantial compensation payments for the provision of the universal service (5%-10% of turnover). However, despite the high compensation payments, Correos is currently one of the least profitable postal operator in Europe (rate of return of around <1%).

The universal service in Spain is currently financed by public funding from the state. A universal service fund is already established in law but not in force. At any rate, the competitor's contribution to finance the universal service would probably be modest (0.5% of their net revenues and a license fee of € 1,500). In the view of CNMC, the contribution of the National Budget to the fund would in any case be important.[109] Therefore, the effort to introduce the universal service fund would not be worthwhile if the universal service would be mainly financed by the state again.

105 See Correos, Annual Report 2014 and 2013.
106 See Correos, Annual Report 2014.
107 See Correos, Annual Report 2008-2014.
108 See Correos, Annual Report 2008-2014.
109 Interview with CNMC.

8 USO funding in United Kingdom

The UK was one of the first countries in Europe that abolished the reserved area in the postal market. By 2006, the UK postal market was fully opened to competition. However, Royal Mail is still the dominant operator in this market.

In recent years, the scope of the universal service in the UK was under discussion. In August 2011, after a period of consultation, the regulator Ofcom decided to change the composition of the universal service and to remove bulk mail products from the universal service. The current scope of the universal service is shown in Table 7.

Table 7 Legal requirements for postal universal service in the UK

Scope of universal service	Transit time target(s)	Frequency of delivery
National and international: • Single-piece letters • Single-piece parcels up to 20 kg • Registered and insured services up to 10kg • Return to sender services • free-of-charge postal service to the blind and legislative petitions	National: • Letters and parcels: 93% (D+1), and 98.5% (D+3) • Registered and insured services: 99% (D+1) International items: 85% (D+3), and 97% (D+5)	6 days per week for letters and 5 days per week for parcels

Source: Postal Services Act 2011, section 30, and Designated USP condition 1 as at 1 April 2014.

In May 2015, Royal Mail's only serious competitor Whistl, a subsidiary of the Dutch Incumbent TNT Post, suspended its end-to-end-deliveries.[110] So the market share of Royal Mail is around 99%.

Royal Mail is regulated by the postal services regulator Ofcom. Royal Mail is obliged to provide the universal service in the UK. In the March 2012 regulatory framework, Ofcom designated Royal Mail as the universal service provider in the UK until at least 2021 (10 years from the passing of the Postal Services Act 2011).[111]

Post Office Ltd. (POL) is the retail arm of Royal Mail and responsible for the Post Office network. The company is owned by the UK Government through Postal Services Holding Company Limited, which also holds the government's stake in Royal Mail. As part of the Postal Services Act 2011, POL became independent of Royal Mail Group on 1 April 2012. POL is entrusted to deliver the public service obligations by an entrustment letter from the Minister for Employment Relations, Consumer and Postal affairs up to 2018.[112]

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110 BBC News (2015), Whistl suspends post delivery service putting 2,000 jobs at risk, article of 11 May 2015, http://www.bbc.com/news/business-32686828.
111 Designated USP condition (2012).
112 Entrustment letter dated 23 January 2015 from Jo Swinson MP, the Minister for Employment Relations and Consumer Affairs.

8.1 Various funding mechanisms in place

In the UK, there is a colorful bouquet of financial aid possibilities to support Royal Mail:

- Universal service fund
- Rural network support payments
- Restructuring aid
- Relief of legacy pension costs

Universal service fund

The British postal law provides a way to discharge the cost of the universal service through a universal service fund. From October 2016 onwards, Ofcom may review the extent of the financial burden of Royal Mail from complying with its universal service obligation.[113] If Ofcom comes to the conclusion, that complying with its USO imposes a financial burden on Royal Mail, they have to submit a report to the Secretary of State. The report should set out its recommendations for actions that Ofcom considers should be taken to deal with the burden. The Secretary of State must then determine what action should be taken and may direct OFCOM to take that action.[114]

The British postal law also permits Ofcom to establish a universal fund to finance the financial burden. Ofcom further may establish a universal fund and determine the contributions to be made for meeting the financial burden. The British postal law states that postal operators providing services within the scope of the universal postal service and/or users of universal postal services may contribute to that fund. The specific configuration of who exactly has to contribute to such a fund remains open to Ofcom. Ofcom is also responsible for the assessment, collection, and distribution of the contributions. However, before implementing the universal service fund, the Secretary of State and the House of Parliament must approve the regulations by resolution.[115]

Rural network support payments

POL is entrusted by the Minister for Employment Relations, Consumer and Postal affairs to maintain a post offices network above its optimum commercial size (at least 11,500 post offices) with several minimum access criteria. Despite investments by the UK government and significant cost reductions, the British post office network continues to operate at a loss.[116]

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113 Postal Services Act from 2011, Art. 44.
114 Postal Services Act from 2011, Art. 45.
115 Postal Services Act from 2011, Art. 46.
116 Entrustment letter dated 23 January 2015 from Jo Swinson MP, the Minister for Employment Relations and Consumer Affairs.

Therefore, the UK government has specified measures to compensate POL for its net costs of maintaining its network of post offices above its optimum commercial size by a funding agreement (usually for 3-4 years) signed between the Secretary of State for Business, Innovation & Skills and POL. The funding agreement contains a detailed and precise explanation of the parties' obligations in the delivery of the public services.[117]

The forecasted net costs of Post Office Network are based on the 'net avoided cost methodology' and are calculated as the difference between the expected net costs for POL when providing the public postal services and the expected net costs/profits for POL when operating without any obligation of providing public postal services.

Restructuring aid

Since 2002, Royal Mail has taken significant restructuring measures to modernize its business and drive costs down. Therefore, around 3,000 post offices were closed.[118]

For the period 2008-2016, Royal Mail drew up a further restructuring plan that is focused primarily on reduction of costs and revenue diversification. The restructuring plan included operational modernization, and a structural reduction of mail centers. Royal Mail will finance 50% of the restructuring costs through several measures, such as asset divestments. The restructuring plan also provided access to the delivery network to other postal providers. The UK government supported the modernization of Royal Mail by a huge debt reduction.[119]

Relief of legacy pension costs

The Royal Mail Pension Plan (RMPP) is an occupational pension scheme for employees of Royal Mail and POL. The contribution rate to the RMPP is determined by the UK Pensions Regulator, which was established on 6 April 2005 by the Pensions Act 2004. In 2009, Royal Mail's contribution was set at £ 282m per year. Royal Mail has no veto power over the contribution rate to the RMPP.[120]

The Postal Services Act 2011 envisages that the UK government will assume responsibility for certain of the accrued liabilities under the RMPP. The UK authorities set up a new statutory pension scheme which will be a liability of the UK government. Pension benefits accrued up to 31 March 2012 are transferred to the new scheme. Since then, Royal Mail has to pay only for normal pension contributions for all members of the RMPP, who still work for Royal Mail, and consequently only remain liable for new pension rights acquired after March 2012.[121]

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117 Legal base for funding agreement: section 103 of the Postal Services Act 2000 and section 8 of the Industrial Development Act 1982.
118 Commission Decision of 28 November 2007, Case N388/2007.
119 Decision of the Commission of 21 March 2012, Case SA 31 479, OJ L279, 12 October 2012.
120 Decision of the Commission of 19 March 2015, Case SA.38788.
121 Decision of the Commission of 19 March 2015, Case SA.38788.

8.2 Experience with funding mechanisms

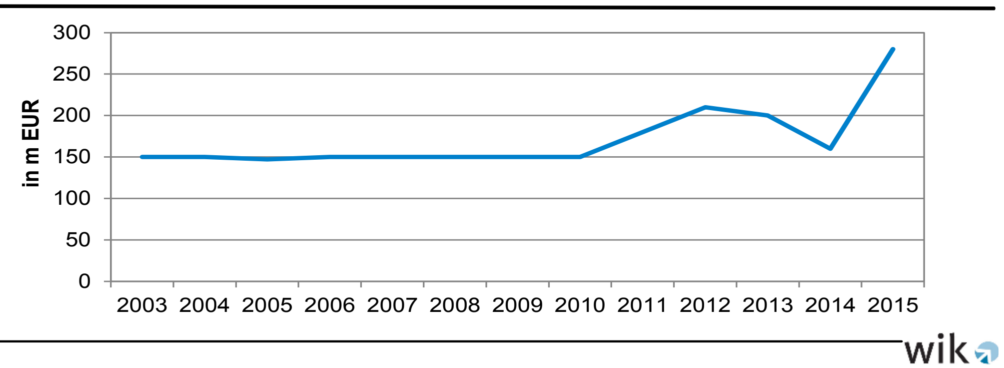
Although the British Post Offices Act provides for a universal service fund, the calculation of net costs is suspended until at least October 2016. Until now, the universal service fund has not been implemented in the UK.

Royal Mail and POL receive financial aid by rural network support payments, subsidies for the transformation of the post office network, and relief of legacy pension costs.

Rural network support payments

POL has been compensated annually for maintaining the commercially non-sustainable rural network within a £ 150 million ceiling up to 2010. From then until today, the payments have risen to £ 280 in the current financial year (2015/2016).

Figure 9 Development of rural network support payments in the UK (2003-2015)



Source: Various decisions of the European Commissions regarding compensations to Post Office Ltd.

Rural network support payments are agreed by a funding agreement between the Secretary of State for Business, Innovation & Skills and POL, and approved by the European Commission in several state aid cases.[122] So far the Commission has approved the rural network support payments in any case (last in May 2015).[123]

The UK government provides payments for rural network support to ensure that POL is able to meet its debts in full. The compensation measures were designed not to exceed the minimum necessary for Post Office Limited to continue providing the public services entrusted to it.[124] The rural network support payments today amount to around 15-20% of total turnover of POL.[125]

122 Decision of the Commission of 28 March 2012, Case SA.33054, Decision of the Commission of 22 February 2005, Case N 166/2005, Decision of the Commission of 27 May 2003, Case N 784/2002.
123 Decision of the Commission of 19 March 2015, Case SA.38788.
124 Decision of the Commission of 19 March 2015, Case SA.38788.
125 Interview with Ofcom.

Restructuring aid

The UK government granted Royal Mail a debt reduction of £1.089bn in the context of a broad restructuring plan for the years 2010-2015, aimed at ensuring the sustained viability of Royal Mail. In March 2012, the European Commission reviewed the restructuring aid, and demanded for improvements in the restructuring plan of Royal Mail. Further, the UK government shall submit annual reports on the implementation of the restructuring plan to the Commission, until the end of the restructuring plan. The Commission concluded that the aid does not create distortive effects that will be disproportionate to the positive effects of a successful restructuring of Royal Mail.[126]

Already in 2007, the UK government has paid a restructuring aid (£ 184m) for costs for the closure of some post offices as part of a transformation program announced. The Commission has authorized the funding.[127]

Relief of legacy pension costs

The European Commission has approved the plans of the UK government to relieve Royal Mail from excessive pension costs. In broad terms, it is estimated that the new pension scheme will be taking over £ 32.2bn of liabilities and associated assets of £ 27.7bn and hence a deficit of £ 4.5bn.

The Commission's investigation found that Royal Mail was liable for higher pension costs than its private competitors as a consequence of legacy costs. The Commission therefore authorized the pension measure, under the condition that it only relieves Royal Mail of costs which are in excess of the level of pension payments made by comparable companies in the UK. This will ensure that the pension relief does not place Royal Mail in a better position than competitors.[128]

8.3 Assessment of how well funding mechanisms have worked

A universal service fund has not yet been installed. According to Ofcom numerous other questions are connected with a possible introduction that has to be clarified in advance. This includes in particular the questions of who should contribute to that fund and which service should be part of the universal service.[129]

The UK government takes the view that the post office network performs an important social and economic role. Post offices (especially in rural areas) act as focal points for the communities and are used by many citizens as sources of information and advice

126 Decision of the Commission of 21 March 2012, Case SA 31 479, UK - Royal Mail, OJ L279, 12 October 2012.
127 Decision of the Commission of 28 November 2007, Case N388/2007.
128 Decision of the Commission of 21 March 2012, Case SA 31 479, UK - Royal Mail, OJ L279, 12 Oct 2012.
129 Interview with Ofcom.

on Government services.[130] Therefore, the government is still willing to pay for the provision of a post offices network above its optimum commercial size through state resources. This raises the question of if that is really needed and how long the government wants to support the rural postal network.[131]

Further, the UK government wants to support Royal Mail by subsidizing the modernization process of Royal Mail on the one hand, and by taking certain liabilities over from the RMPP on the other, and thereby contributing to the restoration of Royal Mail's viability.[132] The support for modernization measures makes sense as long as the measures are meaningful. However, this is monitored by both the UK government and the European Commission. The takeover of legacy pension costs from Royal Mail will also be useful to provide a level playing field.

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130 Commission Decision of 28 November 2007, Case N388/2007, p. 3.
131 Interview with Ofcom.
132 Decision of the Commission of 21 March 2012, Case SA 31 479, UK - Royal Mail, OJ L279, 12 Oct 2012, p. 8.

9 Strengths and weaknesses of USO funding mechanisms in Europe

For the financing of (potential) net costs of the universal service, we have identified four general options: (i) a compensation fund, financed by all relevant service providers and/or customers, (ii) public funding, (iii) state liability for legacy labor costs, and (iv) public procurement of universal services. For each funding mechanism, this chapter discusses strengths and weaknesses, based on the European experience.

Compensation fund

A compensation fund is financed by contributions ('special tax') either on postal service providers or their users. In practice, contributions to compensation funds are usually a fixed percentage on revenues from postal services, typically letter services or universal services (i.e. letters and standard parcels).

Nearly all benchmark countries (France, Germany, Italy, Spain, and UK) have authorized establishment of a compensation fund by law. Italy is the only country in the benchmark that has already established such a fund. In Italy, contributions to the fund are limited to 3% of the licensee's gross revenue from universal service. However, the Italian authorities reported difficulties collecting the contributions from the operators. Therefore, the compensation fund is not sufficient in Italy. According to incumbent Poste Italiane, only less than 1% of the USO net costs were collected via the fund.[133]

Belgium has removed the option to establish a universal service fund from the postal law recently, to avoid legal uncertainty and negative effects on competition. Instead, direct state funds are used.[134]

Table 8 Strengths and weaknesses of universal service funds

Strengths
➢ USO funded by the industry, no need for tax money
Weaknesses
➢ The collected funds are usually not sufficient to finance the USO (e.g. in Italy, it accounts for only 1% of the USO net cost)
➢ High requirements for all postal operators (e.g. in Italy, Germany, and Spain): requirement to keep separate accounts for universal services and other services, and obligation to report annual accounts
➢ Costly to administer for regulator (examination of financial data of all operators, determining the basis for contributions, managing the fund)
➢ Obligation to contribute has negative effects on competition (Reason for removing the compensation fund from the postal law in Belgium)

Source: Assessment of WIK based on discussions with various postal market experts.

133 Interview with Poste Italiane.
134 Interview with BIPT.

State funding

The USO is funded either by direct or indirect transfer payments from the government. In nearly all benchmark countries (Belgium, France, Italy, Spain, and UK), the USP receives some direct payments from the government.

Payments from the state budget can take various configurations and terms, e.g.:

- Direct government contributions to finance the USO in Spain and Italy
- Subsidies for the post office network in the UK, France and Belgium
- Financial support for the delivery of publications in France and Belgium

Table 9 Strengths and weaknesses of state funding

Strengths
➢ Accountability: Politics determine level of USO, and pay for the cost
➢ Secure funding and more certainty for USP (reason for Belgium to remove the option of a compensation fund from the postal law)
➢ State funding of services of general economic interest (SGEI) allowed by EU state aid rules as long as the four Altmark criteria are satisfied
➢ Relatively low administrative cost for the government
Weaknesses
➢ Poor incentives for USP to reduce cost of USO (since that cost is funded by the government)
➢ Risk of over-compensation of the USP, that can have a negative impact on competition

Source: Assessment of WIK based on discussions with various post-market experts.

State liability for legacy labor cost

The State assumes liability for the extra cost of civil servants (or otherwise higher labor cost), and adopts payments, e.g. contributions to pension funds. In two benchmark countries (Germany and UK), the state had assumed (totally or in part) the USP's contributions to pension funds:

- The German government has compensated Deutsche Post for the high pension costs of civil servants that were considered a legacy of public ownership. This compensation was examined by the European Commission for the years 1995-2010. The Commission concluded that Deutsche Post had effectively borne significantly lower social contributions than its private competitors and ordered the recovery of € 500m to € 1bn. Deutsche Post and Germany have appealed against the Commission decision at the ECJ. The actions are still pending.
- In the UK, Royal Mail was relieved from excessive pension costs of its civil servants. Pension costs up to 31 March 2012 were transferred to the new scheme. Since then, Royal Mail has to pay only for normal pension contributions of their current workforce. The Commission authorized the pension measure.

Table 10 Strengths and weaknesses of the state liability for legacy labor cost

Strengths
➢ Instrument to create the same conditions regarding social security contributions between postal service providers and to establish a level playing field
Weaknesses
➢ Not clearly related to USO – different topic, but sometimes combined in political discussions/decisions
➢ The adoption of payments reduces incentives for the USP to reduce pension cost
➢ Hardly transparent funding mechanism; often no transparency about the amount and calculation method of the aid until it comes to a review by a judicial procedure (e.g. Deutsche Post case)

Source: Assessment of WIK based on discussions with various post-market experts.

Public procurement of universal service

(Parts of the) universal service can be publicly procured. The winning bidder is the one that takes the minimum subsidy for the service. This funding mechanism is an inherent part of the designation process. The regulator defines the USO and organizes the tender for its provision.

The postal laws of two benchmark countries (in Belgium and Germany) foresee a public procurement for parts of the postal service.

- In Germany, a public procurement is foreseen in the case that the universal service is not being adequately provided by Deutsche Post any more. So far, Deutsche Post has never claimed compensation, and there has been no need to activate the mechanism.
- In Belgium, the distribution of press items will be awarded through a bidding process from January 2016 for a period of 5 years. The bidding process is currently ongoing.

Table 11 Strengths and weaknesses of public procurement of universal service

Strengths
➢ Public procurement could ensure that the USO is assumed by the most efficient operator
➢ Public procurement could help to reduce the amount of fund required to ensure the provision of the USO
➢ Net costs need not be calculated because the service providers compete on the minimum subsidy
➢ Public procurement is unlikely to create any issues of illegal state aid
Weaknesses
➢ Risk that there are too few bidders or collusion among them - and hence inefficient outcome of public procurement
➢ Difficult to prepare the public procurement (define the request for proposal / scope of USO)
➢ Risk of time lag: USO net cost can only be compensated prospectively, not retroactively

Source: Assessment of WIK based on discussions with various post-market experts.

Assessment of the funding mechanisms

Compensation funds have only been applied in Italy to date. Such funds are costly to administer and that it is difficult to determine the correct revenue basis for calculation of contributions in advance. In Italy, funds collected represent only a minimal fraction of USO net costs. Overall, European experience suggests that compensation funds are not an appropriate mechanism to finance the net costs of the USO. In the USA, with a monopoly, it is even more likely that funds raised by a compensation fund would be insufficient to support the USO.

The adoption of USP pension contributions by the state is often discussed in the context of universal service but in fact it is not clearly related to the USO. Rather, with the adoption of pension contribution the state assumes liability for legacy labor costs. We see this as a transitory means to reduce excessive labor cost that the USP has inherited from the public sector, and thereby create a level playing field among all market participants, and allow the USO to compete on equal grounds.

Public procurement of (parts of) the universal service is a good option in theory, as it can ensure that the USO is assumed by the most efficient operator. Further, a public procurement can help to reduce the amount of funds required to ensure the provision of the USO. The net costs of the USO need not be calculated, because the service providers compete on the minimum subsidy. However, this funding mechanism has a major drawback: regulators face a difficult challenge of designing procurements so that they attract bids from operators other than the incumbent. Furthermore, this mechanism is not compatible with a statutory monopoly (as in the USA).

In our view, public funding by the state therefore is the most appropriate solution. Public funding has the advantage that the state who determines the scope of the universal service also bears the cost. It gives the USP more certainty on the one hand. But on the other hand it involves the risk that the USP anticipates that all the losses will be offset by state subsidies, and therefore has insufficient incentives to reduce its costs. Administrative costs for public funding are relatively low.

Our conclusions are supported by the European Commission. In an interview conducted for this study, Werner Stengg (Head of Unit "Public Interest Services" at European Commission, DG GROW) said: “In a first step, efforts should be made to reduce the cost for the provision of the universal service e.g. by adjusting the scope of universal service. Further, it is only fair that the one who has ordered the universal service will also pay for it.” He also points out that it makes more sense to close existing small or regionally limited universal service gaps than to use a shotgun approach.

Imprint

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Appendix B: Management's Comments

THOMAS J. MARSHALL
GENERAL COUNSEL
AND EXECUTIVE VICE PRESIDENT

UNITED STATES POSTAL SERVICE

March 17, 2016

RENEE SHEEHY
DIRECTOR, RISK ANALYSIS RESEARCH CENTER
U.S. POSTAL SERVICE OFFICE OF THE INSPECTOR GENERAL

SUBJECT: Funding the Universal Service Obligation (Final Draft Review)

Thank you for the opportunity to respond to the final review draft of the white paper, "*Funding the Universal Service Obligation*." While we largely agree with the paper's general approach to the issue, we would like to communicate two points.

First, we believe that the universal service obligation (USO) includes more attributes and pertains to more facets of the Postal Service's activities than your office's previous white papers might suggest. According to the Postal Regulatory Commission's 2008 *Report on Universal Postal Service and the Postal Monopoly*, the USO includes not only delivery frequency, delivery mode, access to Post Offices, and affordable prices – the four attributes that were the focus of Report No. RARC-WP-15-007, *What Postal Services Do People Value the Most? A Quantitative Survey of the Postal Service Universal Service Obligation* – but also the Postal Service's nationwide geographic scope, the range of products offered by the Postal Service, quality of service, and users' rights. All of these other attributes, which are grounded in statutory requirements and the public's needs, contribute significantly to the cost of the USO. In its *Annual Report to Congress and the President* for fiscal year (FY) 2015, the Commission estimated that the USO cost the Postal Service \$4.13 billion in FY2014. As your white paper acknowledges, the Postal Service has taken the position that the full cost of statutory mandates is much higher than that.

Second, the paper (at page 6) claims that historical experience with small price changes gives no insight into how mailers would respond to larger price increases. While that statement may be true, it does not account for the fact that the Postal Service's price elasticities were not materially affected by large price increases in the past. Nor does it account for the fact that many foreign posts, such as Canada Post Corporation, Australia Post, Royal Mail (UK), and other European posts, have introduced large price increases in recent years, with positive revenue results. Based on publicly available information, the subsequent volume declines that those foreign posts experienced appear to be in line with the Postal Service's traditional elasticities.

for

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