

Alternative Funding Models for the Universal Service Obligation

The European Experience

Research prepared for the USPS OIG

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Who is WIK?

- WIK ('Scientific institute for infrastructure and communication services')
 - Independent research institute, owned by the German government
 - ~ 40 consultants/researchers
 - 30 years of experience with sector policies and economic regulation
 - ICT, postal services, digitalisation
- WIK-Consult is a 100% subsidiary of WIK
 - Consultancy specialised in regulated industries, founded in 2001
 - Focus on public sector clients, primarily EU institutions and regulators
 - ~ 60% of revenue from customers outside Germany

Postal Reform in Europe

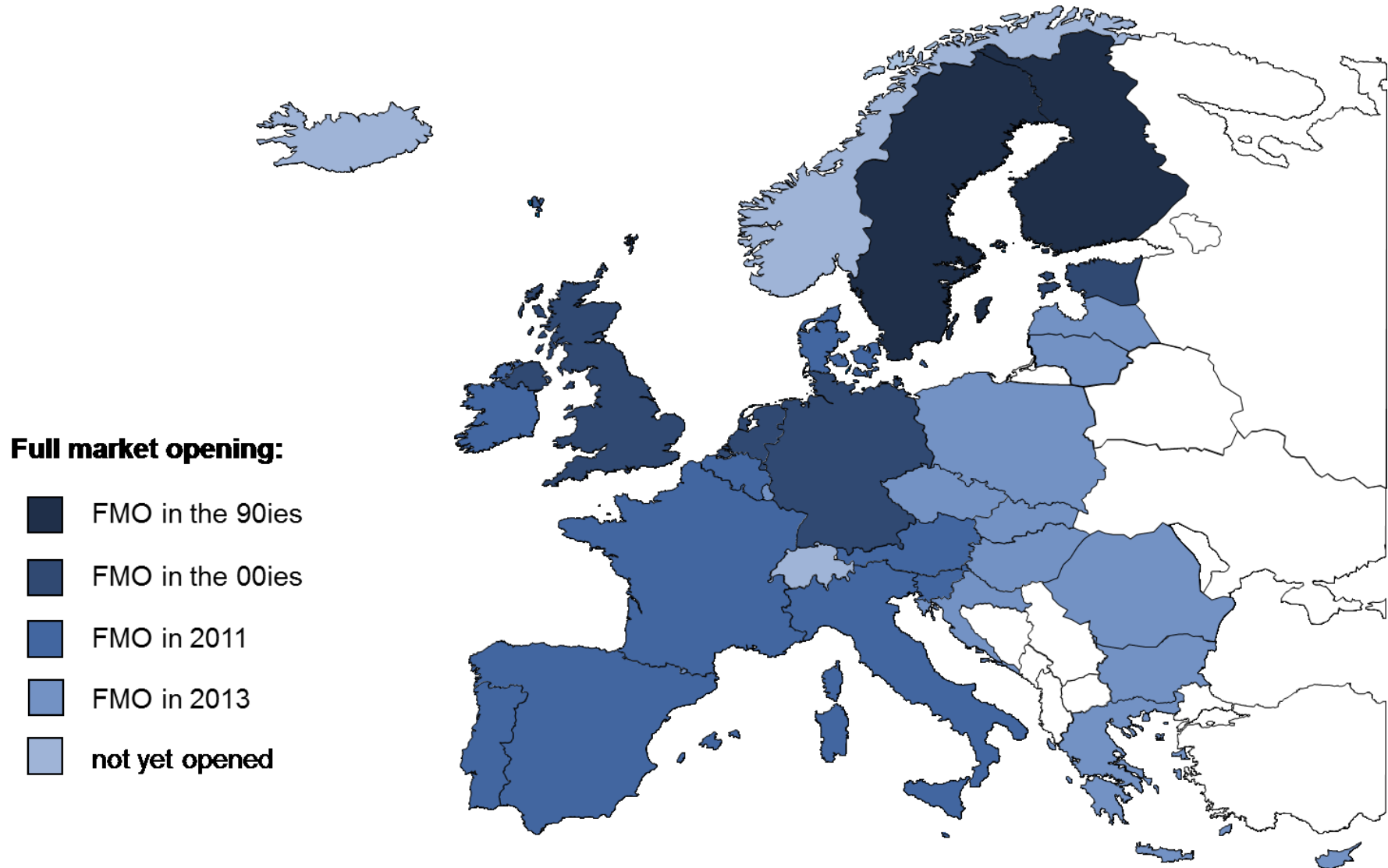
- Liberalization
- Privatization
- Universal service

WIK study on funding models for the USO in Europe

- Compensation funds
- State liability for legacy labour costs
- Public procurement of universal services
- Public funding by state

Conclusions

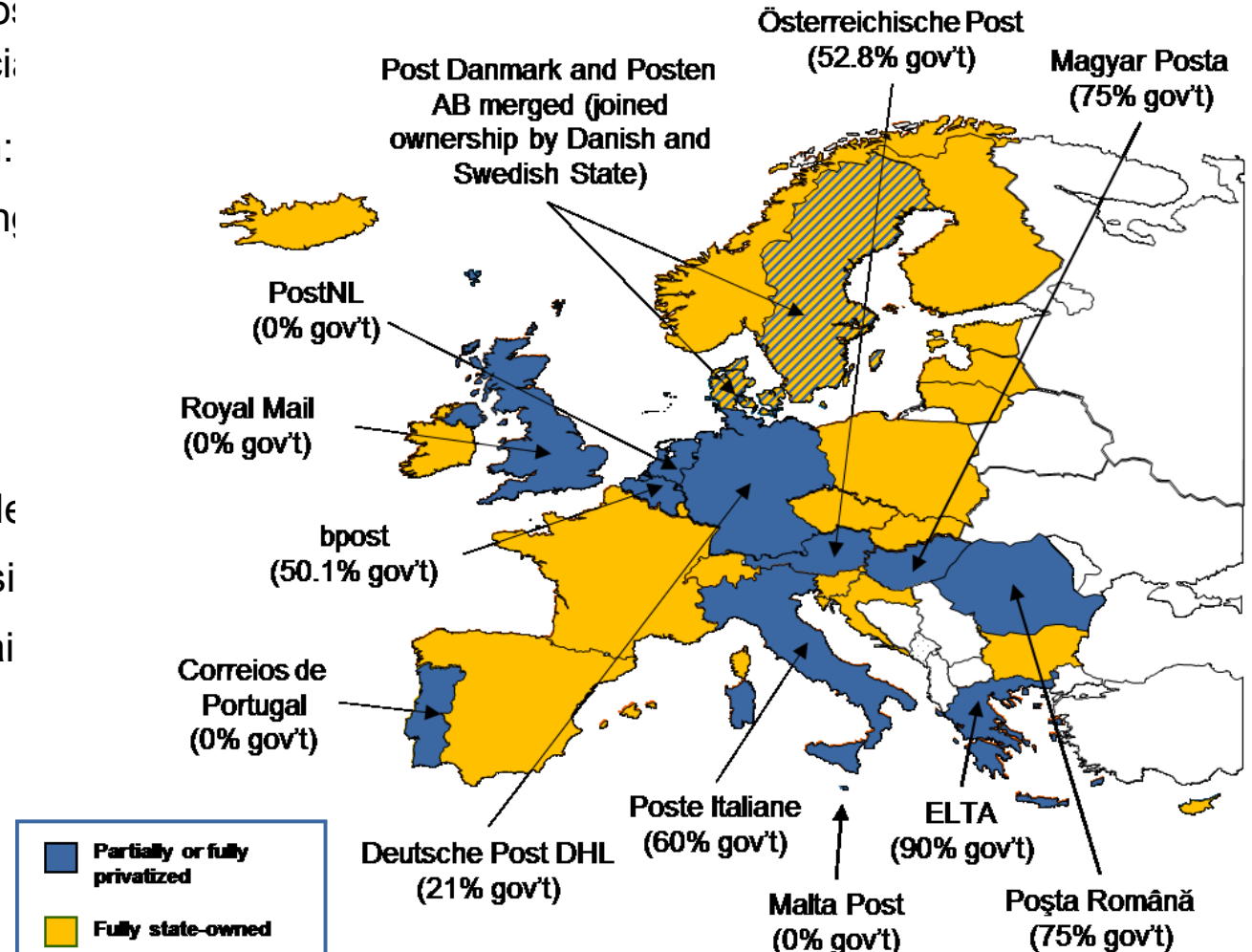
All EU Countries Have Liberalized Post



Postal Reform in Europe

Many EU Posts Have Privatized

- All EU public operators have transformed from a state postal authority to a company under commercial law
- Two models of privatization:
 - IPO / list at stock exchange
 - Strategic investors
- Results of privatization:
 - Modernized operations
 - Operators more profitable
 - Operators seen new business opportunities
 - Universal service maintained
 - Less employment in core business



EU Law Effectively Protects USO

Scope of the USO:

- Postal items up to 2kg and postal packages up to 10kg (both incl. registered items and insured items)
- Member States may increase the weight up to 20kg

Methods for ensuring universal service:

- Rely on market
- Obligation on provider
- Public procurement

Quality of service:

- Routing time target for national universal postal services
- Monitoring and publication of actual performance

Delivery standards:

- Delivery frequency: Five or six working days a week
- Some exceptions in exceptional geographies

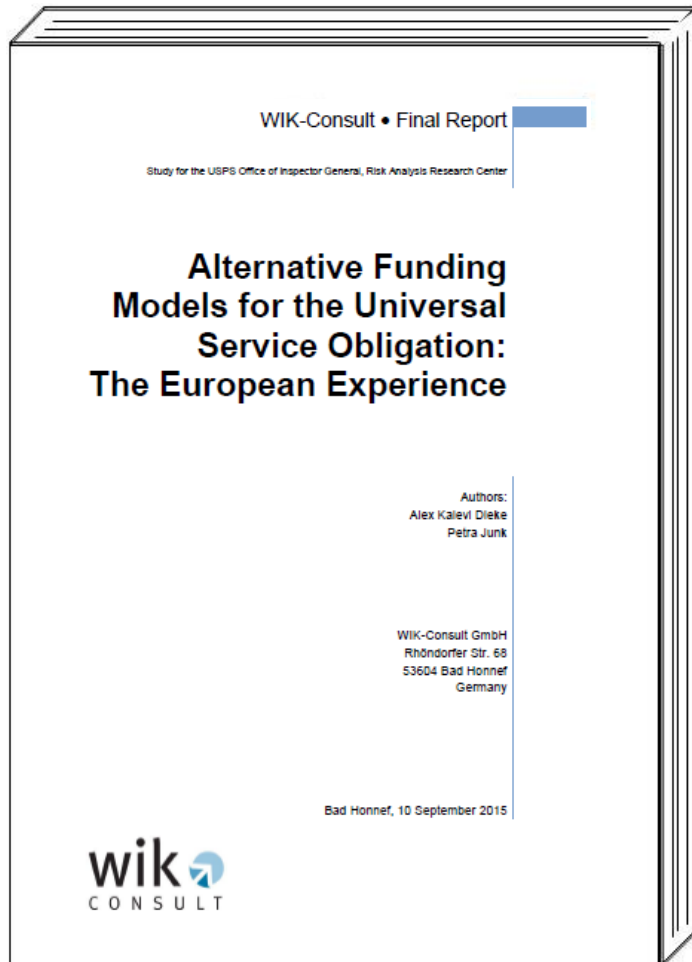
Financing the USO net costs:







- Traditional model: Monopoly profits (up to full market opening in 2013)
- Alternative funding models:
 - Direct compensation from public funds
 - Compensation fund

Standards for retail infrastructure:

- Standards for postal outlets/offices and public collection boxes determined on state level

WIK Study – Overview



- Study on behalf of the USPS OIG
- Published as an appendix to the White Paper 'Funding the Universal Service Obligation' of the OIG
- Study objectives:
 - Review of the funding mechanisms for the USO in Europe
 - Discuss different approaches and experience
- Analysis of six European countries:
 -  Belgium
 -  Italy
 -  France
 -  Spain
 -  Germany
 -  UK

Four Key Funding Mechanisms in Europe

- 1 Compensation funds
- 2 State liability for legacy labour costs
- 3 Public procurement of universal services
- 4 Public funding by state

An Option in Law, But Rarely Used in Practice

Description

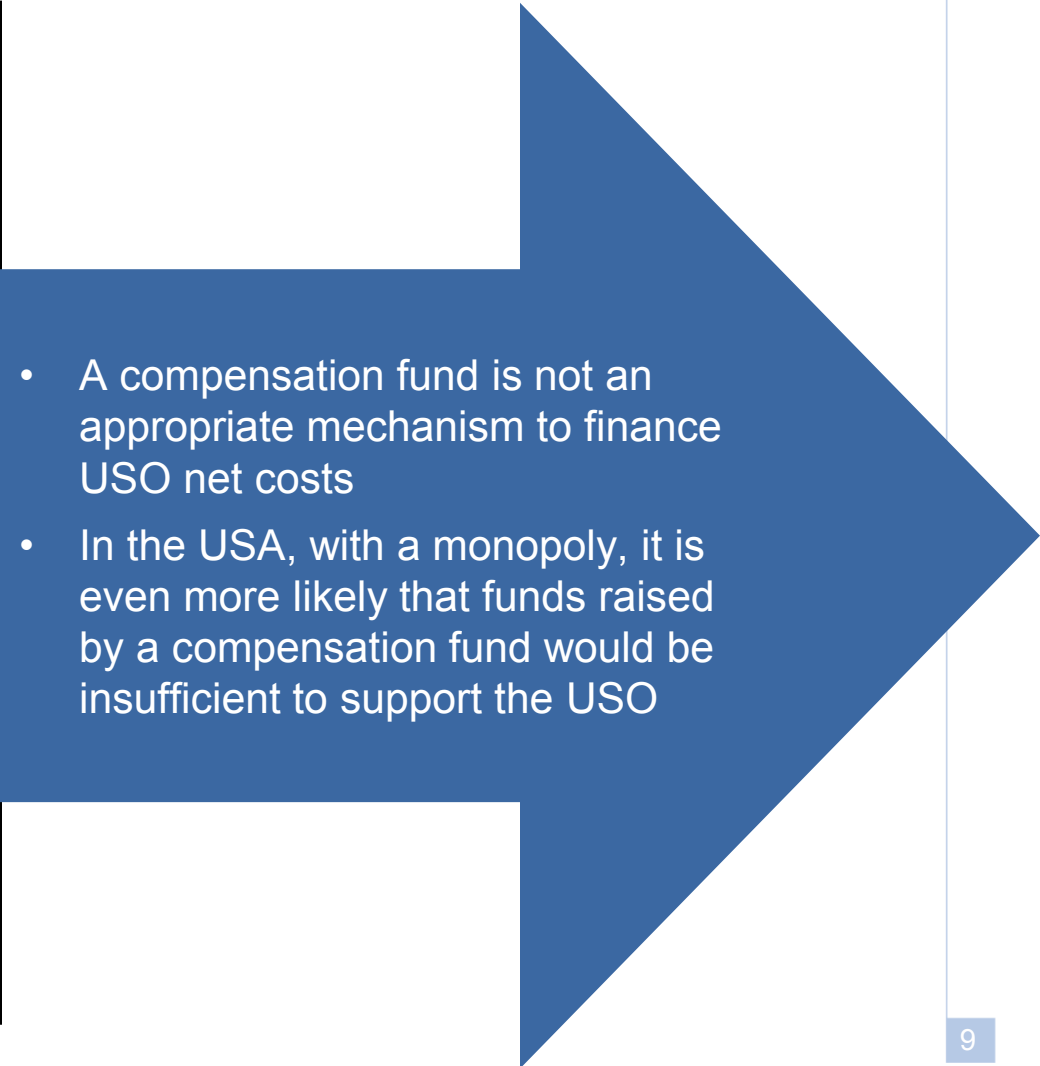
- Financed by contributions ('special tax') either on postal service providers or their users
- Contributions are usually a fixed percentage on revenues from postal services (typically letter services or universal services)

Application in Europe

- Italy: Compensation fund in operation, but covers only <1% of net costs
- France, Germany, Spain, and UK: Option in law, but not implemented

Funds Do Not Seem Appropriate to USPS

Strenghts
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 compensation funds from law in Belgium)



- A compensation fund is not an appropriate mechanism to finance USO net costs
- 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

EU Gov's Help Posts Reduce Labor Cost

Description

- State assumes liability for the extra cost of civil servants (or otherwise higher labor cost)
- State adopts payments, e.g. contributions to pension funds

Application in Europe

- Relief of pension costs of civil servants
 - Germany: ~ € 37bn for 1995-2010
 - UK: >£ 32bn for new pension scheme

Important For Posts, But No Clear Link to USO

Strenghts

Instrument to create the same conditions regarding social security contributions between different postal service providers , creat 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)

- Useful, transitory means to reduce excessive labor cost that the incumbent has inherited from the public sector
- Creates a level playing field among all market participants, and allows the incumbent to compete on equal grounds
- However, mechanism is not clearly related to the USO

A Transparent Way to Impose the USO ...

Description

- Procurement of (parts of the) universal service
- Winning bidder takes the minimum subsidy for the service
- Regulator defines the USO and organizes the tender for its provision

Application in Europe

- Procurement of press items (Belgium)
- Option in law since 1998, but no need to be applied in practice so far (Germany)

Public Procurement of Universal Services ... but Difficult to Prepare and Design

Strengths

Public procurement can ensure that the USO is assumed by the most efficient operator

Public procurement can help reduce the amount of funding required to ensure the the USO

Net costs need not be calculated because the operators compete on minimum subsidies

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

- Good option in theory, but with a major drawback in practice: regulators face a difficult challenge of designing procurements so that they attract bids from operators other than the incumbent
- The mechanism is not compatible with a statutory monopoly (as in the USA)

State Funding For USO Widely Used in EU

Description

- Funded by direct or indirect transfer payments from the government
- Various configurations and terms, e.g.:
 - Direct government contributions to finance the USO
 - Subsidies for the post office network
 - Financial support for the delivery of publications

Application in Europe

- ...for the provision of the USO (Italy: <1% of the USO net costs; Spain: ~5% – 10% of turnover)
- ...for public service missions (Belgium: ~12% of turnover)
- ...for the post office network (UK: ~2% of turnover of Royal Mail Group; France: ~1% of turnover)
- ...for lower press tariffs (France: ~1% of turnover)
- ...for reduced-rate tariffs (Italy), restructuring aid (UK) and capital contributions (Spain)

Public Funding by State

The Most Practicable Option

Strengths

Accountability: Politics determine level of USO, and pay for the cost

Secure funding and more certainty for the incumbent

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 the incumbent 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

- Administrative costs for public funding are relatively low
- State determines the scope of the universal service and bears the cost
- More certainty for the incumbent. But risk that the incumbent anticipates that all the USO losses will be offset by state subsidies, and therefore has insufficient incentives to reduce its costs

Conclusions

- The decline in letter volumes and associated drop in mail revenues has eroded the ability of the U.S. Postal Service to fund its USO
- **For supporting the USO in the United States (if that is necessary), public funding by the state is the best of the alternatives we examined**

- European Commission officials confirms our conclusions:
 - *“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.”* Werner Stengg (Head of Unit "Public Interest Services" at European Commission) in correspondence with WIK
 - 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



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