

PRIVATE CORRESPONDENCE

Competition or Monopoly in Australia's Postal Services?

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Robert Albon



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The Author

Robert P. Albon lectures in economics at the Australian National University. Originally from Melbourne, he studied at La Trobe, Monash and Australian National Universities. Prior to joining the ANU in 1976, he worked with the Industries Assistance Commission in Canberra. His research interests are largely in the areas of public and applied microeconomics, and he has published many articles and books on topics such as rental, agricultural and financial markets; applied welfare economics; and taxation policy. He has a strong interest in public issues and has written for the popular press.

Foreword

When Milton Friedman defended the principle of freedom of entry into any occupation, he did so by reference to the most difficult case — medical practice. Robert Albon, in urging the privatisation of Australia Post, is following a similar tactic. If he can convince us of the wisdom of denationalising an activity that is a government monopoly in every country in the world, then presumably we will not strain on such gnats as Telecom, Qantas, and the Commonwealth Bank.

Government operation of postal services is usually rationalised on the grounds that the postal network is a natural monopoly, and that public monopolies are better than private monopolies. Dr Albon questions these time-honoured assumptions. He doubts that postal service is a natural monopoly and argues that, even if it is, a privately-owned (but unprotected) monopoly is likely to operate more efficiently than a protected public monopoly. In reaching these conclusions he draws on market contestability theory (i.e. on the notion that competition for a market is a partial substitute for competition **within** a market) and on insights into the performance of public enterprises provided by comparative institutional analysis.

There is currently much interest in privatisation of government enterprises as a means of cutting Leviathan down to size. This is doubtless because the British Conservative Government has had more success with privatisation than in controlling ordinary government expenditure. In delineating the various groups benefiting from our existing postal arrangements — the employees, the gainers from cross-subsidisation — Dr Albon both exposes the political uses of public corporations and identifies the major potential opponents of privatisation.

Ross Parish

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This topic of research was suggested to me by Greg Lindsay at a time when mountains of mail were accumulating in Canberra as the consequence of a serious industrial dispute. Private courier services were doing a thriving business and attention was again on the costs of a public monopoly mail system. This beginning, combined with my unabashed and deep-seated suspicion of both public ownership and monopoly, has given this study a rather critical flavour which did not escape the attention of some readers of earlier drafts. I have attempted in the various revisions to be objective and to place the arguments for the *status quo* in the best possible light.

Many commentators have helped me in preparing this study. I have given seminars at the Australian National, Monash and La Trobe Universities on aspects of the study and these have elicited a number of helpful comments. Others have read earlier drafts of this monograph. In particular I am grateful for comments and suggestions from Buz Brock, Rod Kemp, Greg Lindsay, Ross Parish, Jonathan Pincus, Bruce Pollock, Ian Senior, Ted Sieper, Chris Trengove and two anonymous referees. Of course, all the mistakes and other deficiencies are my own work.

Others, and some of those mentioned already, have helped with the provision of information and with the preparation of the manuscript. Both Greg Lindsay and Rod Kemp have provided me with reference material from a wide range of sources. I have also had the benefit of discussions with some official sources connected with the postal service. Ian Senior provided information on the British postal system. Debbie Hodgkinson (formerly of the CIS) and Christina Jankovic (of ANU) both provided helpful research assistance. Preparation of the typescript has been performed ably through several drafts by the ever-patient team of Gillian Scott and Coralie Cullen at ANU and Meredith Cameron at the CIS. Finally, I am most grateful to Rose McGee for her expert assistance at the editing stage.

Chapter 1

What's Wrong with the Post Office?

All the major postal systems of the world are organised as government-owned firms with significant monopoly powers, at least with regard to the handling of 'letters'. However, the search for a convincing economic case for public postal monopolies is not very fruitful. Indeed, our research has uncovered strong arguments for the complete removal of both the monopoly and state ownership.

The existence of special interests who would lose from such a change, and the lack of a special interest group (other than the public) who would gain, does not augur well for the introduction of competition and private ownership of postal services. However, there are forces at work that could change this situation.

The letter monopoly has been with us a very long time. So has public ownership. These features were introduced in Australia by the British colonial administrations and have never been seriously questioned. The maintenance of the *status quo* has been reinforced as recently as 1982 by the Committee of Inquiry into the Monopoly Position of the Australian Postal Commission (1982) — the Bradley Committee. While it makes some useful suggestions, particularly in regard to financial controls, the Committee effectively recommends no change to the basic postal monopoly position of the Australian Postal Commission.

The durability of this arrangement is a fascinating topic for investigation. Why, in the absence of a strong case for it, is the public postal monopoly such a universal and enduring institution?

The most superficially reasonable argument is that providing postal services is a 'natural monopoly'. On the surface, it seems

reasonable to expect that it would be cheaper for one postman rather than several to service a street. Our review of this argument and the empirical evidence for it, presented in Chapter 4, suggests that it does not justify monopolisation and certainly not **public** monopolisation. Neither economies of scale nor economies of scope appear to be present in regard to postal services. The Bradley Report's recommendation to continue the monopoly is not based on the natural monopoly argument. The Australian Treasury (1983), in its submission to the Bradley Committee, sees some merit in the argument although it does not pursue the line to any great extent. Indeed, no observers seem to take the natural monopoly argument very seriously.

Even if the postal industry were a natural monopoly, that would not necessarily justify statutory restriction of entry. The theory of contestability establishes conditions under which freedom of entry actually deters waste and cross-subsidisation. These conditions may well be approximately met in the postal services industry.

Another case often made for preserving the postal monopoly is that there are so many of them around the world. It has been argued that international mail arrangements could be put at risk by removal of the Australian public monopoly. The Bradley Committee believes that it is 'highly unlikely that satisfactory arrangements could be developed to cater for the domestic delivery of international mail by a number of operators' (p.46). We argue in Chapter 4 that this type of justification for the government monopoly has no firm basis and that the development of a comprehensive private postal network is highly likely if, in the event that Australia Post's statutory monopoly is removed, it vacates the area entirely.

Yet another case for the present system is 'cross-subsidisation', i.e. the over-charging of some users to raise revenue to provide concessional rates to other users. There are two major cross-subsidies in the Australian system, and rural interests are the major beneficiaries of both. These cross-subsidies are the uniform Australia-wide postage rate and the registered publication concession. The Bradley Committee seems to be sympathetic to the cross-subsidisation argument, reflecting the Committee's belief in the extreme importance of Australia Post's 'community service' obligations. In Chapter 5 the argument for monopoly on the basis that it allows cross-subsidisation is rejected on the grounds that any cross-subsidisation is both inefficient and inequitable. If government does intend to subsidise particular groups in the community, this is most efficiently done in other ways.

The Bradley Committee's recommendations seem also to be based on a concern about the financial vulnerability of the Australian Postal Commission if its monopoly were removed.

There is a fear that private competitors would 'skim off the cream', leaving Australia Post to supply only unprofitable services. Even if it is thought desirable to continue operating loss-making services, this can be handled better by allowing competition and cross-subsidising via a revenue surcharge. The monopoly and cross-subsidisation questions are quite independent.

In Chapters 6 and 7 we argue that Australia Post, by engaging in cost-padding, has operated at unnecessarily high cost levels to the benefit of management and staff, but to the detriment of postal users as a whole. Its resistance to technological change has damaged the public's interests. Further, it has clung tenaciously to a monopoly that has on many occasions allowed the public to be held to ransom by the postal unions (see Chapter 8).

Traditional solutions to these problems have involved tinkering with the control and organisation of the public monopoly. For example, in 1975 Australia's postal system was removed from departmental control, separated from telecommunications, and made a statutory authority. Administrative changes such as these, which are reviewed in Chapter 9, are of limited value. A radical departure from the tired old proposals is necessary. As argued in Chapter 10, only the removal of the letter monopoly, perhaps combined with privatisation, can have any real effect in achieving an efficient and effective postal system. As Friedman (1975:286) notes, complaining about the public postal monopoly's behaviour 'is like berating a dog for barking instead of purring'.

There exist various competitive forces that could limit the monopoly power of the Australian Postal Commission. In particular the private courier services provide effective competition on many postal items including, perhaps, some covered by Australia Post's monopoly. Another competitive element is provided by the document exchange system.

There is also enormous potential for new technology (the 'electronic letter') to make the traditional mail monopoly ineffective. The advent of this competition introduces a new element into the politics of the post as it seems to give the postal service a vested interest in meaningful reform — **unless** it sees the opportunity to extend its monopoly to cover electronic mail. Such extensions have significant historical precedents in Australia as evidenced by the public monopolisation of telegraph and telephone services in the nineteenth century. Further, Australia Post seems to be lobbying for retention and extension of its monopoly privileges. Baumol (1983:17) 'can only suspect that operators of government enterprises who demand legal protection from entry are seeking immunity from the consequences of the shortcomings of their own performance. No doubt . . . they proceed . . . they proceed in the conviction that their motives are pure, but like the rest of us, they are apt to ration-

alise the requirements of self interest as the embodiment of the general interest of the public'.

The appeal in this monograph is that, at the very least, the existing forces of competition — electronic transmission, courier services, the document exchange, etc. — are not emasculated by government regulation. Competition in most circumstances acts in the public interest. It has been absent too long in postal services in Australia.

Of course the underlying policy message is far more radical than simply not smothering competition. It is an appeal to open completely the postal system to competition. Given the propensity of government to subsidise and otherwise prop up its inherently inefficient agencies, an efficient postal service may also require privatisation. This seems to be the conclusion of Senior (1983) in regard to the United Kingdom postal service. Privatisation of a wide range of public enterprises has also been recommended by Littlechild (1983).

In the introduction to this study I expressed some rather negative thoughts about the effects of public postal monopolies, especially Australia's. However, the pervasiveness of government-owned postal monopolies has served at least one very useful purpose — it has stimulated a number of liberal economists to some of their best writing. The Nobel Prize winning economist Milton Friedman has written on the United States postal service and it has been difficult to resist quoting him extensively in this volume.

Another liberal, Frank Chodorov, examines the history of the United States Post Office in his 'The Myth of the Post Office' (1948). Chodorov questions whether 'a government monopoly is a public service . . . since its existence is not dependent on voluntary patronage' (1948:2). He also asks the very relevant question of whether the promotion of the postal business as a 'collective instrument' implies that this 'instrument [must] be implemented with police power' (p.2). Chodorov also refers to (and illustrates) the 'art of milking the public treasury via the Post Office Department' (p.5); the 'pollyannaish hopes of public-ownership advocates' (p.7); the fact that 'not a single development in the mail service came from within . . . every one was forced by private enterprise' (p.11); and a belief that 'if the Government had kept its hands out of mail business, the pioneers would have developed a mail service comparable to the telephone system, and the taxpayer would have saved uncountable deficit billions' (p.12).

The United States Postal Service (USPS) is reviewed more recently in a very entertaining (and disturbing) study by Bovard (1985). The USPS is referred to as a 'dinosaur' producing a service that is becoming slower, more expensive and less reliable. Bovard reinforces and updates the strong case made by Chodorov some 37

years earlier. If anything, the situation is getting worse, not better, prompting Bovard to advocate competition: 'The ideal solution is to open the floodgates of private competition . . . In 200 years, government has yet to reveal a genius for the task [of operating the postal service]. As long as the mail is carried by a tenured bureaucracy with no incentive to move quickly, service will continue to be slow, expensive and doubtful' (1985:17).

Another piece of writing of considerable note is Ronald Coase's (1961) account of the rise and fall of messenger services as a consequence of their exploitation of a loophole in the British Post Office's monopoly. The exception to the monopoly allowed sending a letter by a 'messenger on purpose', which gave rise to messenger companies who employed people to deliver written communications. However, in 1869 the activity of a firm set up to exploit this loophole, the Circular Delivery Company, was determined to be illegal. It was held that the letters were being sent by the company, not by the individuals who actually wrote them.

This did not end the matter as certain university colleges and student unions developed private posts. Under pressure all of these were disbanded except that of the Oxford Union Society. While the British Post Office was preparing to act against the Oxford Union, the Boy Messengers Limited was set up by Richard King. The development of this and other companies elicited the expected response from the Post Office. A long saga of political activity ensued as the public monopoly strove to protect itself from competition. However, a number of factors, including technological change, eventually led to the demise of the messenger companies.

An interesting by-product of the messenger companies story was the debate in *The Times* between the famous Cambridge economist Alfred Marshall, and an anonymous correspondent who turned out to be the Post Office Solicitor. Marshall, in a rare excursion into the public arena, strongly advocated a competitive postal system and ridiculed the shallow case for monopoly. In the course of this debate, Marshall made one of the first (perhaps the first) estimates of consumers' surplus loss as a result of monopoly. His estimate was a figure of £4.6m per annum.

Millar, a contemporary of Marshall's, also criticised the British Post Office. Millar (1890) was surprised that many supporters of state enterprise cited the Post Office as a successful instance of government ownership. While acknowledging that the postal service appeared on the surface to be impressive and well coordinated, Millar criticised factors such as over-charging (of which he provided considerable evidence); the 'arbitrary and frequently impudent manner in which the Post Office treats its customers' (p.395); the slowness, excessive cost and lack of security of the Post Office's parcel service relative to that of private carriers; the inepti-

tude shown in regard to its banking, insurance and telegraph operations; and the Post Office's efforts (which were later successful) 'to take over the telephone' and 'to obstruct its introduction' (p.408). Millar also provided considerable evidence of a large degree of cross-subsidisation from the basic letter service and pointed out that 'the recent strike among the postmen furnishes a lesson to the commercial world which should act as a warning to the public not to encourage a State monopoly in the means of carrying everything' (p.411).

All of this writing has been to little avail. The public monopoly postal service could, on the basis of the historical record, outlast us all. Would Alfred Marshall have believed that the basic institutional arrangement he criticised would still be intact 100 years later? An institution that has withstood attacks from economists of the stature of Marshall, Coase and Friedman must have something going for it. But that something is certainly not the efficient service of the general public.

Chapter 2

History and Nature of the Australian Postal System

Introduction

This chapter traces the history of the Australian postal system with special emphasis on the acquisition and maintenance of public monopoly power, the practice of price discrimination (usually given the less emotive name of cross-subsidisation), the linkage of the postal service with the telephone system, public acceptance of the system, and the role of government enquiries since the first in 1910 to the latest in 1982. As the Bradley Committee notes, 'Over the years, there have been a number of changes to the official postal services, but the legislative changes have focused mainly on revisions to financial arrangements. There has been little reassessment of the basic principles' (p.21). We give special attention to recent history, particularly since the postal and telephone systems were separated and removed from departmental control in 1975. The major features of the present law (*Postal Services Act 1975*) and practice of the Australian Postal Commission are spelt out in some detail.

This history is mainly descriptive rather than prescriptive. Any reader of the Bradley Report will note the heavy debt owed to that study for much of the information in this chapter. Further information has been drawn from a variety of sources, including Australia Post's *Annual Reports*.

It is perhaps also worth noting that the material in this chapter is not particularly absorbing reading but it is, nonetheless, necessary in a study of this kind. The present situation in regard to

Australia's postal services cannot be properly understood without an appreciation of the history that led to it.

The History of Australia's Postal System

Australian postal services were developed on a colony by colony basis until Federation in 1901. This closely reflected the nature and operation of the British postal service. The history of the postal services in the colonial period is traced by Trengove (1982). Trengove's exacting study informs us about various aspects of the antipodean adaptation of the British system, including the appointment of Australia's first postmaster, a Mr Isaac Nichols, in 1809. The first colonial postal act was passed in 1825.

At the time of Federation the administration of all postal and telegraphic services passed to the Commonwealth Government. The postal monopoly set down in s.85 of the *Postal Services Act* 1975 was derived from s.98 of the *Post and Telegraphs Act* 1901, which in turn was expressed in terms very similar to the relevant New South Wales and Western Australian colonial legislation. All postal functions were transferred to the Commonwealth, but state rates, charges and regulations were those that had prevailed in each colony prior to Federation.

Amalgamating the various previously colonial postal services proved difficult, and in 1908 the Commonwealth Government established a Royal Commission to inquire into and report on the postal, telegraphic and telephonic services of the Commonwealth. That Royal Commission studied such matters as management, finance, organisation, extensions into country districts (particularly remote and sparsely populated areas), and complaints that had been expressed about the services. It reported in 1910.

The Royal Commission on Postal Service (1910) did not directly address the question of justifying the monopoly provisions in the existing legislation. It did however make reference to the monopoly in the following terms: 'Your Commissioners admit the monopolistic nature of the Commonwealth Post and Telegraph Department, but realise the grave danger of its monopolistic characteristics making for Departmental unconcern in formulating and continuing a progressive policy of management'. This was a very astute and prophetic statement. Unfortunately these concerns about the monopoly were not pursued.

In observing that cross-subsidisation between the different branches of the Department was 'inequitable', the Royal Commission suggested that the different services (telegraphic, telephonic and postal) should each be treated separately for financial purposes. This would tend to reduce the scope for cross-subsidisation. However, the Commissioners noted that such

services were often the only means of conveying the necessities of life to those living in outlying districts performing the work of pioneering the country. They expressed the view that uniform postal charges should be introduced but did not suggest that monopoly provisions would be necessary to protect such an arrangement.

Parliamentary debates on proposed amendments to the legislation following the Report of the 1908 Royal Commission did not address the monopoly question *per se*, although the desirability of uniform postal charges and the financial capacity of the Post Office to sustain those charges appear to have been treated as fundamental issues.

It is interesting to note that the 1910 Report recommended organisational changes similar to those that were finally made in 1975. The Royal Commission criticised the administration of the postal services and suggested that the service be placed under a board of management and removed from public service or departmental jurisdiction. This suggestion was not accepted by the Parliament.

A later report to the Government by a businessman (see Anderson, 1915) also sharply criticised the operation of the Postmaster General's Department and recommended a reorganisation similar to that recommended by the 1910 Royal Commission Report. These suggestions were also rejected by the Government of the day.

Cross-subsidisation between different users of postal services has been a feature of the system from the beginning despite the misgivings of the Royal Commissioners. The 'penny post' was introduced in 1911 (under the *Postal Rates Act 1910*), replacing a two-tier pricing system where town letters were one penny and country letters two pence in all states except Victoria and South Australia.

After the early reports there was no major inquiry into the postal service for more than 40 years. The Ad Hoc Committee of Inquiry into the Commercial Accounts of the Post Office (1961) emphasised the community service obligations of the post office and noted that its virtual monopoly position allowed the Government to meet the losses on uneconomic services from profits on other services. The Post Office argued to the Committee that losses incurred on uneconomic services represented a serious financial burden of which the Post Office should be relieved by subsidies. The Majority Report of the Ad Hoc Committee took the view that since cross-subsidisation was required the Post Office should be regarded as a noncompetitive business. It proposed that the business should aim to recover overall the full costs of services from the consumers of those services. The report asserted that providing

uneconomic services did not represent a serious financial burden because losses had almost been made up by profits from other services.

In 1975 the Australian Post Office ceased to be a Federal Government department operating the postal and telecommunications systems. Postal services were put under the control of the Australian Postal Commission ('Australia Post'), and a separate Australian Telecommunications Commission ('Telecom') was set up to run telecommunications. This change was undoubtedly the biggest institutional rearrangement in Australia's communications history. The root of the change was the Report of a Commission of Enquiry, the Vernon Commission, in 1974.

Apart from the administrative changes mentioned above (establishment of separate statutory corporations for postal and telecommunications services), the Vernon Report did not result in any substantial changes to the basic nature of the postal system. Rather than seriously considering the monopoly question, the Report implicitly accepted maintenance of the *status quo* in regard to both monopoly and cross-subsidisation.

The most recent inquiry into the postal system reported in 1982 and was particularly charged with examining the monopoly issue. The Committee of Inquiry into the Monopoly Position of the Australian Postal Commission (1982, the 'Bradley Committee') produced a comprehensive report that effectively recommended maintaining the existing monopoly and cross-subsidy structure, although it did suggest a number of changes to the Commission's financial and capital structure arrangements. The main recommendations of the Bradley Report are summarised and appraised critically in Chapter 9.

The Nature of Australia Post's Activities

The basic statutory functions and duties of the Australian Postal Commission as specified in the *Postal Services Act* 1975 are: the operation of postal services within Australia and between Australia and places overseas; the operation of such other services as the Act authorises (e.g. agency services, money transfer services); the provision of technical assistance outside Australia in the planning and operation of postal services for other countries; and the power to do anything incidental or conducive to the performance of those functions.

An amendment to the Act in late 1983 restored the Commission's power to operate a courier service. The Commission's previous courier operation had been closed down in July 1981. The Act was also changed to give the Commission wide (but not exclusive) powers in regard to the electronic transmission of mail.

The Commission is required to perform its authorised functions in the way that will best meet the social, industrial and commercial needs of the Australian people for postal services, and to make its services available throughout Australia. These obligations are expressed in general terms and it is essentially up to the Commission to decide how to carry them out. In undertaking its functions and duties, the Commission is required to consider the desirability of improving and extending services in light of developments in the field of communications; the need to operate as efficiently and economically as practicable; and the special needs for postal services of Australians who reside or carry on business outside the cities. The latter two requirements may be contradictory, a theme taken up in the chapter on cross-subsidisation.

The Minister has considerable powers over the Commission's operations and may direct it 'with respect to the performance of its functions and the exercise of its powers, as appear . . . to be necessary to the public interest' (*Postal Services Act 1975*, s.8). The Minister also has substantial powers over certain financial matters and these are discussed — together with other financial aspects of the Commission's operations — in the next chapter.

Without doubt the most important element in the legislation regarding the Australian Postal Commission is the monopoly in the carriage of letters in Australia. S.85 of the *Postal Services Act* provides generally that a person shall not convey or carry a letter for reward or cause a letter to be conveyed or carried for reward otherwise than by the Postal Commission. There are some exceptions to the general provision, including letters heavier than 500g; letters concerned only with goods and accompanying those goods; letters related only to the affairs of a person and carried by an employee of that person; and the carriage of letters between a residential or business address and the nearest office of the Commission. An amendment to the Act in late 1983 added a further exemption: domestic or overseas mail carried for at least ten times the Australia Post rate. This amendment was in the spirit of one of the recommendations contained in the Bradley Report. As strange as it may seem, the Act does not define the term 'letter' and for that reason administering the monopoly section has been difficult.

Almost all standard article mail comprises letters that are within the Commission's monopoly. The Commission estimated that in 1980-81 the carriage of letters for which it has a monopoly accounted for about 77 per cent of its total mail volume and about 60 per cent of revenue from mail services. This represented about 50 per cent of total revenue. Since 1980-81 there probably has been a very slight decline in the relative importance of monopoly business.

Private Correspondence

Non-standard article services (excluding non-standard letters) and all parcel services are outside the Commission's monopoly and are open to competition. That competition has come primarily from courier operations, document exchanges, airline companies, state and national rail authorities, and transport companies. There has been considerable growth in recent years in private sector courier services. According to the Bradley Committee most courier services have probably carried items that fall within the scope of the Commission's monopoly. The Committee formed the view that most of these items were time-sensitive and the sender believed they could not be conveyed by the Commission within the time-frame desired.

The Bradley Committee (p.9) prepared the following summary of Australia Post's four basic mail categories (revenues have been updated to 1983-84 figures):

- Standard Article, including enveloped mail, lettercards, etc., as specified in section 18(7) of the Act, weighing not more than 500g and meeting other specified dimensions. In 1983-84 revenue from this category was \$531 million (about 59 per cent of the Commission's total revenue from mail posted in Australia).
- Non-standard Article, including large enveloped material, small packets, business and printed papers, books and merchandise under 500g and outside the specified dimensions of a standard article. In 1983-84 revenue from this category was \$117 million (about 13 per cent of the Commission's total revenue from mail posted in Australia).
- Parcel, described as a postal article weighing more than 500g but not over 20 kg. The upper weight limit of 20 kg is set by the Postal Commission in the By-laws made under the *Postal Services Act*. Revenue in 1983-84 was \$87 million (about 10 per cent of the Commission's total revenue from mail posted in Australia).
- Registered Publication, for publications meeting prescribed conditions for registration for postal transmission at concessional charges. In 1983-84 revenue from this category was \$23 million (about three per cent of the Commission's total revenue from mail posted in Australia).

In addition, Australia Post operates an international mail service in cooperation with the national postal services of other countries. This service provided about \$106m in revenue in 1983-84, representing about 12 per cent of the Commission's total mail revenue.

The Commission has two other mail services: Express Courier and Intelpost. The courier service was suspended for some time in the early 1980s as a result of a Government direction. Intelpost is a domestic and international facsimile transmission service that commenced in 1984. There are no data on the operation of either of these services.

The Australian Postal Commission also engages in a number of non-mail activities, the most important of which are the provision of agency services, the sale of philatelic items, and the sale of postal money orders. The respective revenues in 1983-84 from these services were \$90m (8 per cent of total revenue), \$22m (2 per cent) and \$12m (1 per cent). Agency provision is mainly for the postal service's old partner, the telecommunications service, and for the Commonwealth Savings Bank. The Commission has recently broadened considerably its range of agency services. The latest addition is the introduction of electronic funds transfer at point of sale.

To perform these duties the Australian Postal Commission employs a large staff operating in post offices, mail processing facilities, etc. As of 30 June 1984 there were 32,953 full-time staff, about 85 per cent of whom were engaged in operating post offices and carrying and processing the mail. The Commission had about 2,700 part-time employees and about 8,400 others were engaged in non-official post offices or employed by mail contractors.

The Commission operated 4,843 post offices of which 1,395 were official. About half were in rural areas, almost one quarter were in urban areas other than capital cities, and a little over one quarter were in capital cities. There were 46 major mail processing facilities and over 15,000 post boxes. The Commission's vehicular fleet comprised over 2,500 motor vehicles and 3,636 motor cycles.

Chapter 3

Financial Objectives and Performance

Introduction

Australia Post has never been particularly forthcoming about its financial performance. The recent Prices Surveillance Authority (PSA) Inquiry into Postal Charges forced the Commission to be temporarily more open about its affairs, but even so the PSA noted that 'Details of losses on the registered publications service were made public in the inquiry, as was a volume of other information not usually contained in the main published reports of Australia Post ... The Authority considers that Australia Post should publish the maximum possible detail of its operations' (PSA, 1984:2-3). While we have some idea of the Commission's overall performance, the Commission is reluctant to tell its owners how specific functions like standard mail, the courier service and agency services are doing.

In this chapter we first review the financial features of the *Postal Services Act*, noting in particular the Commission's requirements to cover its costs and to operate as efficiently as possible. We then look at the aggregate 'profit and loss' (surplus and deficit) results and note some reasons for questioning these results as a fair indication of performance. We attempt to adjust the figure for one year by accounting for various factors omitted from the published figures. Finally, we present what is known about the operations of the various functions within the Commission. The material here is necessarily fragmentary because of Australia Post's extreme reluctance to disclose details of its internal affairs.

The Legislative Framework

Since 1975 the post office has operated as the Australian Postal Commission under the *Postal Services Act* 1975. The financial provisions of the Act are quite extensive and the Minister has considerable powers in regard to financial matters. A major feature of the financial provisions is that the Commission is completely exempt from any taxes levied by any level of government — Federal, State or local — in Australia. This exemption gives Australia Post a significant advantage over its competitors. The Commission also has an advantage in regard to capital costs.

The major statutory financial obligations of the Postal Commission (s.76) are to pursue a policy that seeks revenue sufficient to meet all expenditure and provisions for expenditure properly chargeable to revenue; and to provide for capital expenditure a sum equal to at least half the proposed annual expenditure on fixed assets, plus the movement in the value of working capital (i.e. depreciation). The Act specifies that the provisions for expenditure properly chargeable to revenue in a year include depreciation (albeit not on a current cost basis) and contingent liabilities. The Commission is required also to operate as efficiently as possible. The Minister is required by s.79, after consultation with the Commission, to determine how any surplus achieved each year should be spent.

S.76(2) requires the Commission to keep its rates and charges as low as practicable, consistent with its major financial obligations under the Act. The Commission may determine postage rates and other charges, but only with the approval of the Minister may the Commission change postage rates on standard postal articles and registered publications (s.18). The Minister is not entitled to dictate to the Commission the particular rates it shall charge, but he can indicate the level of charges he would be prepared to approve and the level of any concessional rates he believes should be provided for particular classes of persons. When requesting approval for a rate change for standard postal articles or registered publications, the Commission is required to estimate the proportion of capital expenditure it expects to provide out of revenue, and the level of revenue for the year if the change is granted.

Under certain rather complex conditions, and after making two approaches to the Minister, the Commission is entitled by s.19 to be reimbursed by the Commonwealth where the Minister's refusal to approve a determination of postage rates for standard articles and/or registered publications proposed by the Commission has prevented the Commission from achieving its overall financial objective under s.76(1) of the *Postal Services Act*. No reimbursement is available if the Minister, in refusing to approve a proposed

determination, had notified the Commission of the rates of postage he would be prepared to approve, and the Commission had not made a determination fixing or varying the rates in accordance with the Minister's notification.

This set of procedures has recently been changed (see Chapter 9). The Commission's proposed charges on standard postal articles and registered publications must now be scrutinised by the PSA, perhaps via a public inquiry. However, the Authority has only an advisory role in regard to charges.

When the Postal Commission was established in 1975, its accumulated surplus, defined in s.74 as the amount by which the balance sheet value of assets (at **historical cost**) exceeded liabilities assigned to the Commission, was deemed to be a loan to the Commission from the Commonwealth. That loan is subject to interest charges as determined by the Minister for Finance and is repayable to the Commonwealth under terms and conditions determined by that same Minister. The nature of the capital commitment and the conditions of its repayment give the Commission a significant financial advantage over its competitors.

The Commission is required (s.80) to keep appropriate accounts in accordance with commercial practice and to ensure that all payments are correctly made and properly authorised and that adequate control is maintained over assets and liabilities. It is required by s.81 of the Act to provide the Minister with estimates of its projected receipts and expenditures for each financial year in such a form as the Minister directs.

Overall Profitability

On the basis of what is known, the postal service has not been particularly profitable even without being required to account fully for its true economic costs. Only now does there seem to be any prospect of the postal service being required to cover its full **actual** costs. If this happens it will perhaps be the one significant achievement of the Bradley Report.

Early in the century the postal section of the Post Office was profitable, offsetting losses elsewhere to some extent. Aggregate postal profits were earned despite losses on some unprofitable services. After the introduction of the penny post in 1911 postal profits began to decline. However, postal services remained the only profitable section of the Post Office during the 1920s. In the post-war period prior to the establishment of the Australian Postal Commission in 1975, postal services provided continual profits only in the early 1960s. For most of the period 1945-75 postal users were subsidised by telephone users, a reversal of the pre-war situation.

TABLE 3.1
Australian Postal Commission Surpluses and Losses
1975-76 to 1983-84 (\$M)

Financial Magnitude	Year									
	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	
Revenue	505.6	561.6	578.7	646.5	690.2	782.1	887.4	999.4	1095.8	
Expenditure*	474.0	532.7	576.6	623.9	678.5	794.8	906.6**	990.6	1071.6	
Operating Surplus (Deficit)	31.7	28.9	2.1	22.6	11.7	(12.7)	(19.2)	8.8	24.2	

* Expenditure includes an item for depreciation. Depreciation is calculated on a straight-line basis over the life of the asset.

** Includes an abnormal depreciation of \$20m.

Source: Australian Postal Commission, Annual Report, various years.

Figures for Australia Post's operating surpluses and deficits for the years 1975-76 to 1983-84 are set out in Table 3.1. On the basis of published profitability the Commission appears to have done quite well until 1977-78, when it dipped markedly. After this poor result the surplus rose in 1978-79, only to again decline over the next three years. Deficits in 1980-81 and 1981-82 were followed by a small surplus in 1982-83 and a larger one in 1983-84.

Profitability is not a particularly good indicator of performance in the case of a publicly-owned enterprise with exclusive trading rights and significant cost concessions. Profits could come from the exercise of monopoly power, the effects of cost advantages, and accounting procedures based on historic costs. On the other hand, the absence of profits is not necessarily a good sign either. The enterprise could, for example, be using profits on parts of its business to subsidise other parts, or it could be earning implicit profits and disguising them in the form of cost-padding. In short, we must look beyond dollar profitability as a barometer of performance of public monopoly firms such as Australia Post.

These considerations also mean that it is difficult to draw an overall conclusion about the Commission's profitability. Factors such as the possible existence of padded costs and the practice of cross-subsidisation would tend to lower reported profitability. However, cost concessions like zero taxes and no requirement to meet full costs of capital would lead to overstated profits.

It is possible to make allowances for some of these factors. In particular we have estimates of the costs of cross-subsidisation, and actual capital costs can be roughly ascertained. Unfortunately the extent of cost-padding is not known and the degree of tax concession is difficult to estimate.

Consider the financial year 1980-81, in which the Commission recorded a deficit of \$12.7m. Figures in the Bradley Report suggest that total cross-subsidisation in 1980-81 was about \$44m, comprising about \$24m on the basic letter service and \$20m on the registered publications concession. Adding this back into profits converts a deficit of about \$13m into a surplus of about \$31m.¹

Now consider the cost of capital. While the book value of fixed assets in 1980-81 was about \$221m, the Bradley Committee recommends more than doubling this figure to attain a current value. We will take \$500m as a conservative estimate of the value of assets. If a ten per cent rate of return were payable on this amount, a sum of \$50m would need to be transferred to the Government as a return on all capital. In fact, interest payments in 1980-81, based

1. Another cost disadvantage Australia Post has is that it is obliged to contribute to a generous superannuation scheme. Unfortunately the excess cost of this is difficult to estimate, but it is thought to be quite substantial.

on the Commission's 'liability for funds provided by the Commonwealth ... [of] \$39.9m' (*Annual Report*, 1981-82:51) were only \$2m. On these bases we would have required a net transfer of \$48m to the Commonwealth, which would turn \$31m surplus into a deficit of \$17m. A requirement to pay taxes would have further added to this deficit.

The Success of the Various Operations

As noted in the previous chapter, Australia Post operates various services in addition to standard mail. These include non-standard mail, parcels, registered publications, international mail, agency services, the courier service and Intelpost. No complete information is available about how the various operations fare, but what sketchy information we could find is assembled in this section and summarised in Table 3.2.

TABLE 3.2
Australia Post's Revenues and Costs by Function
1983-84

Function	Revenue	\$m Costs	Surplus/Deficit
Standard Letters*	531 (440.5)	? (418.9)	? (21.6)
Non-standard mail	117	?	?
Parcels	87	?	?
Regist'd Pub'tions	29	51	-22
Other Domestic Mail	23	?	?
International Mail	106	?	?
Courier	?	?	?
Agency Services	90	?	?
			(likely surplus)
Philatelic Services	22	?	?
Postal Money Orders	12	?	?
Total	1096	1072	24

*Figures in parentheses for 'ordinary standard articles' are from evidence presented to the Prices Surveillance Authority, November 1984.

Sources: various.

Even the available information should be treated with caution because of the 'joint-costs' problem inherent in a multiproduct enterprise such as Australia Post. Where facilities are jointly used for more than one purpose, arbitrary rules are frequently used for allocating the common costs to the various functions. As Peat, Marwick, Mitchell Services note, 'accounting policies and practices used to develop apportionment formulae for the allocation of common costs are of critical importance in determining costs attributable to a particular service. No matter how rigorous the underlying . . . analyses used to develop apportionment formulae they always contain an element of subjective judgement and estimation' (Appendix G of Bradley Report, pp. 171-172).

The arbitrariness of common cost allocation by accountants means that profitability calculations of Australia Post's various operations may be essentially meaningless; it would also allow cost or profitability calculations to be tilted in favour of or against particular operations.

Consider first the standard mail operation. This appears to be profitable according to figures released at the recent PSA Inquiry. The Commission earned revenue of \$440.5m and incurred costs of \$418.9m in this operation in 1983-84. This means a profit of \$21.6m on Australia Post's largest single function, despite the huge subsidisation within the standard mail services of rural users by a tax on urban ones via the uniform charge. If the rural cross-subsidy is about \$30m, the implicit tax on urban users is very significant, about \$50m in total.

Now consider the group of all other mail services, including non-standard articles, parcels, international mail and the courier service but excluding registered publications. This is a very large category with total revenue of \$333m in 1983-84. Non-standard articles comprise the largest single component. The Commission has deemed information about these services too sensitive for public disclosure. It is possible only to speculate about costs but it does seem likely that this area runs at an overall profit. This conclusion is reached in the following way: the profits on standard mail are roughly offset by the loss on registered publications. But the Commission as a whole made a surplus of about \$24m in 1983-84. This suggests that unless agency services are spectacularly successful, other mail services do make a profit. The performances of the individual mail services other than standard mail and registered publications are unknown, although it seems likely that the courier service runs at a loss.

The Commission voluntarily informs us about the final mail service, registered publications. It chronically runs at a considerable loss as shown in Table 3.3, at least according to the published figures. Australia Post seems to be waging a curious campaign

against the registered publications concession by exaggerating its extent. Consider the Commission's claim at the PSA inquiry that it required a 72.5 per cent increase on registered publications to break even. This would have taken a standard-article-sized item in Category B to about 28c, not all that much less than the standard letter rate. But the registered publication item is delivered to the post office presorted by postcode, giving rise to considerable savings to Australia Post. It is quite conceivable that these savings would exceed five cents, so that the requested increase could be a considerable exaggeration.

TABLE 3.3
Financial Results from the Registered
Publications Service
1975-76 to 1983-84 (\$M)

Year	Revenue	Expenditure	Deficit
1975-76	12.5	22.0	9.5
1976-77	12.5	23.1	10.6
1977-78	11.7	23.5	11.8
1978-79	13.2	22.4	9.2
1979-80	12.5	24.7	12.2
1980-81	17.4	36.7	19.3
1981-82	???	???	???
1982-83	25.?	46.3	21.?
1983-84	29.1	51.2	22.1

Sources: Bradley Report, p.135; Annual Report 1982-83 and Australian Postal Commission (1984). Gaps by courtesy of Australia Post.

The most important nonmail area of activity is agency or counter services, which generated revenue of about \$90m in 1982-83. While the costs are unknown there is some reason to believe these services are profitable. Peat, Marwick, Mitchell Services thought there was 'cross-subsidisation between agency services and mail services' (Bradley Report, p.172), but full details are not given.

Finally, we consider one other area — Intelpost. Launched early in 1984, Intelpost is a domestic and international facsimile transmission service with a coordinated courier service at the receiving end. Australia Post has not released any details as yet but is reported to regard the new venture as successful (*Financial Review*, 6-8-84).

Commercial-in-Confidence

Why is all this information so hard to come by? One of the reasons Australia Post offers for its secrecy is 'commercial-in-confidence'. I have always found this argument unconvincing for several reasons.

The most important of these reasons is that Australia Post has a statutory monopoly over much of its business. There are no effective competitors for the major mail services, and therefore there is no reason for withholding information on the grounds that it will advantage competitors.

Second, where competition does exist (e.g. in the courier and parcel areas) there seems to be little reason for Australia Post to be involved in the area at all. There is obviously no natural monopoly in these areas, nor is there any public service obligation. Australia Post must therefore justify its involvement on commercial grounds. Its failure to provide the information necessary to settle this question gives rise to the suspicion that these competitive areas are being supported by profits from elsewhere.

Finally, given its public ownership and monopoly privileges, Australia Post must be fully accountable to Parliament and, through it, to its owners. The onus of proof for **not** disclosing financial information lies with Australia Post.

Chapter 4

Is There A Natural Monopoly?

Introduction

Perhaps the most superficially relevant argument for a postal monopoly is that the provision of postal services is a 'natural monopoly'. The traditional definition of natural monopoly is an industry where the average costs of producing a single product decrease with output (i.e. there are economies of scale) such that one firm can provide any given level of service more cheaply than a number could. More recently another basis of natural monopoly has been suggested, i.e. economies of scope, which occur when a range of products can be produced most cheaply by a single firm because of production interrelationships between the different products.

The natural monopoly idea has recently been subjected to considerable re-examination. Economists such as McKenzie and Tullock (1978) and Baumol, Panzar and Willig (1982) have developed a theory of 'contestability' of markets, which specifies conditions under which industries with economies of scale (or scope) can be disciplined by being subjected to market pressures. Where these conditions are met, allowing freedom of entry will eliminate monopoly profits, cost-inefficiency and cross-subsidisation.

The contestability outcome will be better (in terms of social optimality), the less are economies of scale or scope. If these are not very significant, the price and quantity outcomes from allowing freedom of entry will differ only slightly from their socially preferred levels. It is therefore important to examine the empirical evidence for these economies.

Even if the conditions for contestability did not hold and there was a case for natural monopoly, it would not need to be a **government** monopoly. A private monopoly could operate the system, almost certainly at lower costs. However, international postal agreements involve arrangements between the various national **public** postal monopolies, and it has been argued that we should retain our government monopoly so as not to put these arrangements at risk. This argument is also reviewed in this chapter.

Natural Monopoly and Contestability

It is important to determine whether there are economies of scale and/or scope in the postal system. If there are not, it should, in the absence of other good reasons for regulation, be open to competition. However, even if there are such economies, it does not follow that there should be a monopoly protected by legislation. A better outcome may be attained by allowing freedom of entry.

McKenzie and Tullock (1978) discuss the free entry solution in decreasing cost cases, and note the possibility that price will tend to equal average cost. This outcome may not be as good as marginal cost pricing but it is socially better (in the sense of lower price and higher output) than the standard monopoly solution. Where average and marginal costs are not very different from each other, the free entry outcome is appealing.

The importance of free entry has been further emphasised in the recent literature on contestability (Baumol, Panzar and Willig, 1982; Baumol, 1983). According to contestable market analysis, three conditions are necessary for a perfectly contestable market: the absence of sunk costs (i.e. the ability to withdraw from a market costlessly), equal access of an entrant to the incumbent's customers, and equal access to the latest possible technology. Under these three conditions, 'the market mechanism is quite capable of eliciting acceptable performance without government intervention' (Baumol, 1983:2).

These ideas are best illustrated with the aid of a diagram. Figure 4.1 represents the market for the homogeneous product, mail services (M), assuming that the average cost of providing mail services falls as the amount of provision increases. The average cost curve is AC and the marginal cost curve MC. Demand conditions are represented by demand curve D and marginal revenue curve MR.

The private monopolist not subject to the threat of entry would produce where profits are maximised, i.e. where MC and MR are equal, yielding price P^m and quantity M^m . This price-quantity configuration is not economically efficient (assuming no divergence between private and social values) because price, representing the

value to users of another unit, exceeds the marginal cost of producing another unit. The benefits of output expansion would exceed the costs.

Traditionally, what has been regarded as the best outcome from an economic point of view is a price equal to marginal cost, so that the value of the last unit produced (i.e. price) is just equal to its cost (i.e. marginal cost). This means price P^* and quantity M^* are the targets, given that there are no external costs and benefits attached to consumption or production of mail services. In principle, government could intervene to attain the optimal outcome either by subsidising the private monopolist so as to allow it to price at P^* with output M^* , or by producing the service itself. Unfortunately, P^* is below the cost of production so that operation at this point would entail making a loss.

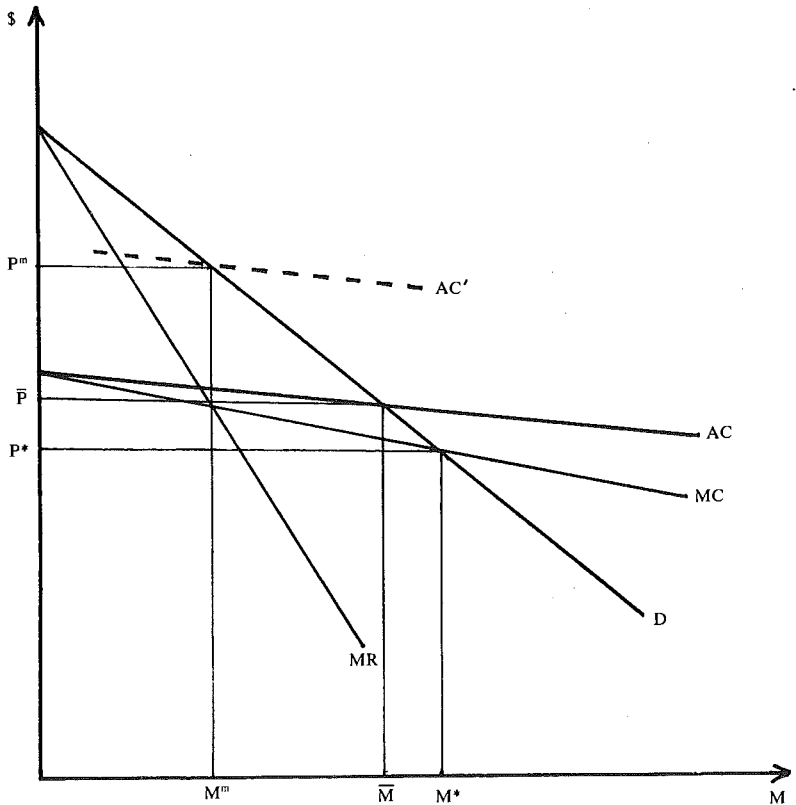


Figure 4.1: The Market for Mail Services.

This loss makes the marginal cost pricing rule less attractive. Neither a private nor a public firm could operate without subsidisation unless it engaged in multi-part pricing. Where this is not possible, the loss would have to be made up from tax revenue. However, unless lump-sum taxes are available, raising tax revenue will create efficiency losses elsewhere, so that the gains from having marginal cost pricing are available only at the expense of dead-weight losses from taxation. Marginal cost pricing may not, in fact, be economically optimal at all.

The contestability solution is, then, a compromise and results in price \bar{P} and quantity \bar{M} . As long as sunk costs are insignificant (i.e. Baumol's costlessly reversible entry) and the other conditions are satisfied, any monopoly profits will attract new entrants who will keep price tending towards the level (\bar{P}) that covers average cost. As long as average and marginal cost are of similar magnitudes (i.e. average costs do not fall very much as output rises) this solution seems quite satisfactory as P and M will be quite close to the economically efficient price and output (P^* , M^*). Costs of entry will be low as long as the factors used in producing the commodity have alternative uses (i.e. costs are not sunk). The entrant must also have access to the latest possible technology (i.e. there must be no legal or other barriers to using this) and customers must not be tied in any way to the incumbent.²

Apart from the \bar{P} and \bar{M} outcome with its absence of monopoly profits, the contestability solution offers two other desirable results. First, it does not allow any implicit profits in the form of cost-inefficiency. Potential or actual entrants will seize upon the opportunity presented by such implicit profits, just as they would with explicit ones. Second, it eliminates any cross-subsidisation as no services can be operated above or below costs under the free entry discipline.

The same circumstances that make freedom of entry attractive when there are economies of scale make it attractive in the presence of economies of scope. Where these conditions are met, the outcome will feature Ramsey prices³ (across all services), absence of cost-inefficiency and no cross-subsidisation.

2. These conditions are those of 'perfect contestability'. Even if they are met only approximately, significant gains are still possible from allowing freedom of entry. Another point worth remembering is that the outcome may depend on how the existing firm reacts to potential challenges. Holding its price constant will make things easier for challengers than maintaining its output level and letting price adjust to the total quantity on the market, including that of its rivals.

3. Ramsey pricing entails mark-ups above marginal cost that are inversely related to the elasticities of demand of the various products of the firm.

Senior (1983) has suggested putting the natural monopoly argument to the market test in regard to the postal system. If natural monopoly is present, the existing postal monopoly should survive such a test given its advantages of size and experience. Baumol (1983:15) has also made this point in a more general context, claiming that there 'may be no more effective test of contestability of the market and the presence or absence of natural monopoly than the ability of competitors to survive. The process ... may perhaps be judged by some to be wasteful, but it can be argued that the survival of the fittest, through which the market normally achieves its efficiency, does exhibit similar patterns'.

Evidence for Economies of Scale and Scope

If there are no economies of scale or scope the argument in favour of demonopolisation is complete — there is no possibility of natural monopoly under such circumstances. This is one reason for looking at the empirical evidence on the relationship between costs and output. The other reason is to determine the quality of the solution that may be expected from allowing freedom of entry. Minor economies of scale or scope will mean a minor deviation from the economically efficient solution.

In the United States context Priest (1975) is very sceptical of the argument for economies of scale, pointing to the lack of available evidence. Wattles (1973) carefully examines the costs of the United States system but draws no overall conclusion in regard to economies of scale. Goodman and Dolan (1979) note that postal services are labour-intensive rather than capital-intensive and conclude that decreasing costs are unlikely in these circumstances. They also claim that 'independent economic studies have shown no evidence of large economies of scale in mail delivery' (p.141). In his discussion of the United Kingdom's postal service, Senior (1983) points to low entry costs ('entry to the market by new suppliers is both cheap and simple', p.22) and notes that 'postal services are labour-intensive and require few skills' (p.22).

The consensus of the overseas literature is that there are no substantial economies of single firm operation in the postal industry. This conclusion also arises from a careful appraisal of the evidence in Australia.

It might seem that Australia Post's widespread network of mail collection, transport, and sorting facilities could be deployed in the handling of different types of mail and that duplicating these facilities would waste resources. This would tend to indicate that even 'cream-skimmers' (i.e. those taking advantage of the fact that Australia Post taxes some users in order to subsidise others) would battle to make a go of it, given the incumbent's advantages.

In fact this has not been the case. A large number of private operators are now offering mail services of various kinds. They cannot all be dismissed as cream-skimming opportunists. There is simply not enough cream around to support this fringe postal industry, whose total business is estimated to be around \$150m per annum and growing rapidly. Besides, the *Postal Services Act* does not allow private operators at the real cream — standard mail.

So despite its huge network, its significant cost advantages, and its ability to use profits in one area to support competitive areas, Australia Post has not been able to keep out the competitors. This fact does not support the natural monopoly hypothesis. Without the same advantages as Australia Post, other operators have duplicated its facilities of mail collection, conveyance, sorting and delivery and have still made a profit.

Nonetheless, intuition suggests that there are economies of single firm operation. Why, for example, is my university mail delivered to a central departmental office and placed in a pigeonhole bearing my name rather than delivered to my office? Is it not obvious that two or more postmen in the one street is wasteful, as one could do the job at a lower cost? In the light of these considerations let us examine specific possible sources of single operator economies.

The Australian Treasury (1983) discusses the issue of single firm economies in its submission to the Bradley and Davidson Inquiries. The Treasury has some sympathy with the idea of scale economies in a number of limited respects. First, it suggests the idea of a local delivery monopoly, especially in rural areas. However, any such economies are likely to be limited and are inconsistent with observations of delivery patterns in urban and rural areas. Second, the Treasury sees some economies of scale in mail sorting, 'although the history of the Redfern Mail Exchange and Australia Post's move to relatively decentralised mail sorting indicates that these economies are exhausted (or outweighed by other considerations) at a relatively low volume of mail items processed' (p.19). Finally, the Treasury reports that 'transport between mail sorting facilities and between them and delivering post offices is likely to demonstrate only limited economies of scale' (p.19). The success of the couriers and the document exchange system supports the Treasury's lack of confidence on these latter two points.

Despite the weakness of its arguments on each of the three points, the Treasury concludes that it is 'likely that Australia Post would continue as the sole provider of **standard** postal services even if its legislative monopoly were removed' (p.19, original emphasis). If this happened it would be the result of factors other than natural monopoly.

Economies of scale and scope are mentioned in the Bradley Committee's Report. The Committee is not impressed with sugges-

tions of economies of scale or scope. It concludes that the 'relatively low capital intensity of the Commission's postal network suggests limited economies of scope or scale for the broad range of postal services' (p.41). The Committee is not persuaded that the postal system is a natural monopoly.

Government-to-Government Relations

Another argument for a monopoly public postal system is the existence of international postal agreements. All postal services around the world are public monopolies with reciprocal government-to-government agreements about international mail movements. Some argue that privatisation or the opening up of the mail service to competition would jeopardise such arrangements.

The Bradley Committee is not sanguine about the prospect of a private mail system in Australia making 'satisfactory arrangements ... to cater for the domestic delivery of international mail by a number of operators' (p.46). The Committee is also concerned about the 'imbalance in international mail transactions between Australia and overseas' (p.46). The Committee concludes its discussion with the statement that 'international mail service considerations do not provide any cause for advocating the **abolition** or substantial reduction of the Postal Commission's existing monopoly' (p.46, emphasis added).

The actual outcome of a private competitive mail system is difficult to predict with any accuracy. The result would depend partly on whether Australia had the only demonopolised, privatised system, or whether deregulated systems were established in other major countries.

Consider first the case of outgoing mail where only Australia has a private competitive postal system. This does not seem to pose any problem as private Australian carriers could either use the official domestic systems of other countries, or make arrangements with private courier operators in those countries where they are legal. Even in the current regulated environment a considerable amount of mail is already delivered overseas in this manner. For example, overseas mail from the Australian National University is sent through Skypak International, which carries the mail to foreign countries and posts it in the official domestic systems.

Now consider outgoing mail where overseas systems are deregulated. Mail would have to be delivered by private carriers in overseas countries. Arrangements would have to be made between private Australian operators and private overseas operators. The success of this system would depend on each Australian carrier being able to rely on a foreign operator (or operators) to deliver on a universal basis or to be able to access a comprehensive network.

Private Correspondence

The establishment of such networks (here and overseas) is crucial to the success of private postal systems. For this reason it is discussed in more detail below.

Now consider the case of incoming mail that would have to be delivered privately. In a competitive environment there could be several private couriers, and it is unlikely that each would boast a national delivery capacity unless they cooperated with other carriers. Again we confront the crucial question of the prospect of a comprehensive national postal network of private firms.

Such a national network is quite conceivable and a highly likely consequence of a private postal system. Already private Australian couriers cooperate to their mutual advantage to provide comprehensive services to their customers. Some companies are strong in some areas and weak in others, giving rise to potential mutual gains. Such arrangements could prosper in a competitive environment.

In the United States an entrepreneur, Scott Adler, has set up a company to do for mailers what a travel agent does for airline travellers (see Dorfman, 1984). World Mail Center, Inc. offers a service where customers bring in an item and are offered a choice of services — pick-up and delivery times, rates, potential discounts, etc. — for any destination. Items are carried by the chosen courier company at their normal rate and World Mail Center, Inc. profits by having negotiated discounts for the service. The company in fact operates as a private profit-seeking post office. A former US Postmaster General is a large shareholder in the company.

There is wide scope for private innovation in the mail area. For example, Security Express in Australia has established collection boxes at locations like service stations. This is the first instance of private post boxes and indicates the type of facility that would develop if Australia Post's exclusive trading powers were removed or relaxed.

The profile of a competitive environment is further explored in Chapter 10. It is impossible to predict precisely how a competitive postal system will evolve, although some pointers are possible. Our predictions are based on observations of the competitive forces that exist now, and on the experiences of other markets that have been deregulated. The discussion in Chapter 10 draws together many strands scattered throughout the monograph.

Chapter 5

Cross-Subsidisation: The Politicisation of Pricing

Introduction

Cross-subsidisation is a universal and enduring feature of public postal monopolies. It may occur between users in different locations (especially urban-rural) or between users of different mail services (in Australia deliveries of registered publications are subsidised by ordinary users). This feature of the national postal system has been with us since the beginning — it was even a matter of concern to the 1910 Royal Commission.

Cross-subsidisation is a consequence of the politicisation of pricing, and it is one of the most undesirable results of placing exclusive power to supply an important commodity in the hands of a publicly-owned firm. Australia Post has been subjected to severe political pressures to levy a tax on some users for the purposes of subsidising others.

The only acceptable reason for not setting prices to reflect the costs of providing various services is that the administrative costs of doing so would be excessive. However, there is plenty of evidence that at least a two-tier rate structure is quite feasible, and in fact such a structure operated in most of Australia prior to 1911.

In the Australian postal system there are two major forms of cross-subsidisation. The most important of these arises because Australia Post charges the same standard postage rate all over Australia in the face of enormous differences in costs. The second is the carriage of certain registered publications at concessional rates.

None of the official post office enquiries in Australia have really faced up to the cross-subsidisation issue, and the Bradley Com-

mittee is no exception. It was charged with examining the monopoly position of the post office with a strong hint that the Government might not be too upset to see it go. The Committee finds in favour of the monopoly and thus is obliged to accept the consequent cross-subsidisation. The Committee does, however, suggest (not recommend) that replacement of the registered publications cross-subsidy with an explicit government subsidy might be desirable.

Is There A Case for Cross-Subsidisation?

It might seem that a uniform price for delivering a standard letter between any two points in Australia is non-discriminatory (and, perhaps, 'fair'). However this would be true only if the **cost** of its delivery were uniform. Where costs vary the use of a standard charge is actually a form of price discrimination.

The use of a standard postage rate dates back to a study of postal costs in Britain in the middle of the last century by Rowland Hill. Hill's report resulted in the advent of the uniform rate penny post. However, as Senior (1983:23) reminds us, 'Hill's view was simply that different rates should not be charged where this would overburden the system with administrative costs. If it can be shown that the system would **not** be overburdened by such rates, the argument for differential tariffs becomes overwhelming' (p.23). Further, Hill's studies showed that in Britain at that time a uniform rate was a fairly close approximation to actual costs of delivery.

Cost conditions are far more variable in Australia than in Britain. It is stretching credulity to believe that carrying a letter from, say, Bourke (NSW) to Launceston (Tasmania) would cost the same as carrying one from Melbourne to Sydney or within the same city. Australia Post itself recognises the cost variations.

Would it be so difficult to devise a charging system that eliminated the major price discrimination inherent in the current system? Could such a pricing structure be introduced at a reasonable cost? The Bradley Committee is not clear on this issue, opining that if there 'were more than say two . . . tariffs, the additional administrative costs involved would outweigh the benefits' (p.47). That quotation implies a belief that at least a dual tariff structure is administratively feasible. However, the Committee does not recommend a move to a dual tariff.

If cross-subsidisation is regarded as an inherent attribute of our economy there are a number of alternative ways to do it. The issues of monopoly, public ownership and non-cost-related pricing should be seen as independent.

One way to proceed would be to maintain the public monopoly and to subsidise its loss-making activities from consolidated

revenue. Services that are currently priced above cost could then be priced on a more rational basis. This method is suggested by the Bradley Committee for registered publications. An explicit subsidy could also be operated with a competitive postal system. Albon and Cheok (1982) suggest such a method to preserve the present cross-subsidisation after deregulation of the financial sector. This has the advantage of allowing deregulation while preserving the previous pattern of political favours.

Yet another alternative has been suggested in regard to the breaking-up of the Bell System in the United States. Brock and Evans (1983) advocate a competitive structure but with a revenue surcharge (tax) on all the unfavoured services. This provides a fund to be applied to the subsidisation of unprofitable routes. Allocations from the fund are made after potential operators make their cases at a public hearing. This has the advantage over monopoly of enabling 'the competitive process to reveal efficient entrants who can advance social welfare' (p.85).

One final possibility is to replace all rural subsidies with one general subsidy. There is currently a plethora of implicit and explicit rural subsidies through things such as telephone charges, water prices, fertiliser subsidies and special income tax provisions. Why not price everything at cost and institute a general 'bush-person's benefit'?

The Extent of Cross-Subsidisation in Australia

We have already noted that there are two major cross-subsidies in the Australian postal system. Both have most of their beneficial impact on rural users of postal services and act to the detriment of the great majority of users. The uniform pricing cross-subsidy is concealed and it is difficult to obtain information on it. The other, which involves a direct concession, is also difficult to evaluate as the concession could, at least to some extent, reflect lower costs of bulk handling and presorting. For these reasons the figuring in this section can only be approximate — 'back-of-the-envelope calculations', perhaps?

In order to assess the effects of uniform pricing it is necessary to explore the extent of the urban/rural cost differential. According to Australia Post (*Annual Report, 1979-80:56*) the extent of this cross-subsidy was 'at least \$15m' in 1979/80. Information provided to the Bradley Committee indicated that 'services for the benefit of rural areas received cross-subsidies from other areas amounting to about \$24 million [in 1980-81]' (p.45). The Committee is of the view that 'Losses from uneconomic components of the basic letter service might . . . be higher than . . . suggested by the Commission' (p.45). The figure is probably now in the region of \$30m.

The basis of this significant degree of cross-subsidisation is the fact that the [then] 'postage of 22 cents is in many cases only a fraction of the cost of delivering a standard letter; this can be as high as \$2.00 or more' (*Annual Report, 1979-80:56*). Our own sources suggest that an intrametropolitan standard letter may now cost only about 15c to deliver.

The Bradley Committee was provided with data on the average processing cost of various 'broad mail path groupings' by the Australian Postal Commission on a 'confidential basis'. These data were 'relatively imprecise' although they did indicate 'some consistent cost variations' (p.42). While the Bradley Report does not reproduce all of these data, it does present costings for two important mail categories, which suggests the possibility of a two-tier rate. Its costing for 1981, when the standard postage rate was 22c, suggested tariffs of 20c 'for deliveries in metropolitan areas of mail originating in the same State'; and of 29c 'for deliveries to country areas of mail originating from interstate' (p.42). Converted to 1985 price levels, when the standard postage rate is 33c, the corresponding figures are about 30c and 44c. The Committee's figuring was based on maintaining Australia Post's current financial position under the existing financial arrangements. Bradley's recommendation to require Australia Post to pay taxes and meet its full economic costs of operation would add to the Commission's costs.

The second significant cross-subsidy is available to senders (and receivers) of registered publications. Access to this concessional service depends on both the nature of the publication and the 'character' of the proprietor. To be registered, a publication must be produced in multiple copies, be issued at intervals announced in advance (generally no less than four numbers a year), not be serialised, not be designed primarily for advertising or sales purposes, and not be in the nature of a book. The 'character' of the proprietor of the publication is specified generally to exclude from eligibility the Commonwealth, State and Territory Governments and statutory authorities or others operating primarily on their behalf. Exceptions are made, however, for subprimary, primary, secondary and tertiary education establishments and some specially defined regulatory and research bodies.

To be granted concessional postage rates, proprietors of publications must generally agree to use the Commission's postal services for delivery of their publications to both low cost and high cost areas. The Commission has discretion, however, to waive this condition in special circumstances. A further condition is that the publications must be produced in Australia.

Eligibility for registration at the full concessional rate (Category A) is available mainly to publications of religious and ex-

service organisations, country publications, publications directed primarily to country residents, and publications directed to assisting the disadvantaged. Category B, which attracts a lesser concession, includes the publications of social, recreational and motorist associations, educational, scientific and technical organisations having as their primary objective the dissemination of knowledge, and organisations of employers and employees.

The registered publications cross-subsidy is quite significant in a quantitative sense. Australia Post in its 1978-79 *Annual Report* estimated the amount involved to be in the region of \$10-12m. In 1980-81 the deficit on the service was \$19.3m (Bradley Report, Appendix E, p.135). As noted in Chapter 3 the deficit has remained roughly constant in real terms in recent years and was about \$22.1m in 1983-84.

In regard to the registered publications cross-subsidy the Bradley Report is more constructive than in some other places. It suggests that the Government appraise the whole basis of the concession and that it 'should be financed by subsidies from the Budget' (p.60). Unfortunately it stops short of recommending the complete removal of this inequitable and inefficient concession. As we noted above, rural people are the major beneficiaries of the registered publications concession. Again the Bradley Committee is unwilling to confront the rural interests who would be harmed by a major attack on the post office monopoly and the associated cross-subsidisation.

Does Cross-Subsidisation Justify the Status Quo?

We must remember that Australia Post does have community service obligations. It is required to cater for the 'special needs' of people in rural areas, and this burden has manifested itself in the maintenance of a national postal network and a uniform pricing structure. The result is a disguised tax on the majority of postal users.

To an extent, the complaints about cross-subsidisation should not be directed at the Australian Postal Commission. The Federal Government is ultimately responsible for the existence of politicised pricing. On the other hand, the Commission is not **instructed** to cross-subsidise rural users; it is instructed to operate as 'economically and efficiently as practicable'.

The Commission's reluctance to reduce the extent of the standard mail cross-subsidy contrasts with its strong campaign against the registered publications one. Trengove (1982) observes that both the postal and telecommunications services in Australia prefer cross-subsidisation via uniform pricing rather than direct concessions. One reason for this is the camouflage offered by the uniform

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price cross-subsidy — ‘As long as those providing the transfer are prevented from knowing its magnitude — actual service costs are not public information — then they are prevented from judging whether increased political lobbying will be beneficial to their interests’ (p.73).

Perhaps the most important point is that cross-subsidisation and monopoly are separate questions. Rather than worrying about ‘cream-skimmers’ undermining Australia Post’s financial viability, emphasis should be placed on the most efficient way of getting the job done. If that job involves cross-subsidisation, then it should be done as efficiently as possible. A revenue surcharge, for example, achieves the same result but with greater efficiency and less subterfuge.

Chapter 6

Should We Expect Public Monopolies to be Cost-Efficient?

Introduction

Theory strongly suggests that when lack of competition and public ownership are combined, the result will be an inefficient operation with excessive costs, poor service, technological backwardness and industrial unrest. The analysis leading to this conclusion is set out in this chapter.

Cost-Padding

There is strong reason to believe that a public monopoly will not produce at the minimum possible cost for any given level of output. Even where financial targets are set to encourage economical operation by requiring an explicit monetary return, a public monopoly still has **opportunities** to pad costs. There are clear incentives for management and staff to incur excessive costs involving perquisites, feather-bedding, the 'quiet life', etc. The opportunities and incentives for such cost-padding behaviour in the case of private firms subject to a maximum allowable profit are discussed in Albon and Kirby (1983). Because of greater agency costs and the uselessness of profits to the operator, the opportunities and incentives are enhanced in the case of public enterprises.

Consider again Figure 4.1 (p.25). In the absence of a subsidy, a firm charged with covering its operating costs would serve society best by operating where price equals average cost (i.e. at \bar{P} , \bar{M}). However, if the government firm acted as a profit-maximising monopolist it would produce at price P^m and quantity M^m , making a profit (price per unit exceeds unit cost). If management

and staff were unable to benefit from **explicit** dollar profits, they could take out profits in indirect ways such as perquisites and easy working conditions. In terms of Figure 4.1 the perquisite-maximising firm would actually incur costs of AC' , which would mean an explicit monopoly profit of zero. This analysis indicates that a firm can be exerting its monopoly power but not necessarily earning explicit monopoly profits.

Further, it can be inferred that the management and staff of a public monopoly would prefer any potential profits to be in the form of excessive costs rather than explicit profits because explicit profits go to the government, not to themselves. Officer (1983:49) suggests that this 'situation is most likely to occur when the enterprise is in a monopoly position . . . but is constrained from extracting monopoly rents through profits or over-payment for factor inputs — in effect they choose an "easier life" and employ extra resources'. As noted in Chapter 8 there may well be some intraorganisation squabbling over the division and nature of the spoils.

The management and staff of a public monopoly are also concerned about the size of their organisation. A large (proxied by output in physical terms) organisation may be important as a source of promotional opportunities, status, etc. To the extent that this is true the firm will look for a higher level of output than would a profit-maximising monopolist. This will, of course, involve lower charges. The relative strengths of the desires for cost inefficiency and size will determine whether the actual outcome is closer to the monopoly or the competitive one.

There is some evidence that size is important to Australia Post. Since the price elasticity of demand for mail services appears to be less than one, a rise in the relative price of mail services results in increased revenue (measured in constant dollars). Perhaps the best example of this phenomenon was in 1975 when the real price of postage rose by about 60 per cent while mail volume fell by only about 15 per cent. Mail revenue rose from \$274m in 1974-75 to \$402m in 1975-76, even though the price increase occurred well into 1975-76 (in September).

Since demand is price-inelastic, the organisation is not fully exploiting its monopoly power. Potential profits would be raised by increasing price. The apparent failure of Australia Post to exploit this potential could be the result of its pursuit of size. In addition to raising total revenue, the price increase would reduce output, perhaps leading to a reduction in 'necessary' costs. Alternatively, Australia Post could be constrained by outside monitoring of its activities. Probably it is some combination of the two.

Agency costs give rise to opportunities for gain. As Officer (1983) notes these will be higher for public firms than for private. Because the ownership of public firms is very diffused compared with private firms, the incentives and possibilities for owners to press for efficiency are much less. Further, it is very difficult to set appropriate targets and monitor costs for state enterprises. In the case of Australia Post, its objectives are rather vague and it has no mechanism for effective cost control. There is a strong need for efficiency audits to check that properly specified targets and requirements are being met.

As noted in Chapter 3, profitability is not a good indicator of performance of a government monopoly like Australia Post. Even if Australia Post sought explicit profits — and we have argued that this is not in the interests of its management and staff — this would not be an indication of efficiency. Anything other than transitory supernormal profits indicate the exercise of monopoly power and are not a desirable outcome of the operations of a public-spirited public monopoly. If it is acting in the public interest there will be no profits, either explicit or implicit.

However, the position is more complex than this. Significant profits might simply reflect the fact that Australia Post does not have to cover the same costs as a private commercial operation. In particular it pays no taxes at all and its capital costs are considerably less than they would be without the gift element inherent in the loan of the Commission's initial (1975) capital from the Federal Government.

Financial matters are a major concern of the Bradley Committee, which devotes an entire chapter to the question of appropriate financial control. It is anomalous that the Committee is concerned about the adverse consequences of a 'Government business undertaking . . . not [being] exposed to the discipline of the market place' (p.55) after it had already recommended protecting the bulk of the Commission's business from competition.

However, the Bradley Committee is concerned to rid the Commission of the very important cost advantages it has over private firms. These advantages are, in the words of the Committee, 'the lack of a requirement to provide a return on assets' and the 'exemption from taxation under any law of Australia or of a State or Territory' (p.55).

The Bradley recommendations to set a financial target and remove the tax exemption would probably reduce Australia Post's ability to take out potential profits in the form of perquisites. Reducing the amount of cost-padding is socially beneficial but the root cause of high charges and other problems — i.e. the statutory monopoly — remains substantially unchanged.

Technology as a Toy

Where management and staff are unable to enjoy explicit profits they will tend to seek implicit means of enjoying monopoly rents. One way for management to do this is to acquire technological play-things useful in producing both real output and management benefits. On the other hand, such technology may not be popular with workers because they believe it will erode long-run job opportunities. These conflicting motivations make it difficult to predict the public monopoly's attitude to technological advancement.

The debate about technology is far more important in the area of telecommunications, which is more capital-intensive than postal services and has experienced significant industrial disputation. However, the 'technology versus jobs' question has not been totally absent in the postal area.

In the case of the Australian Postal Commission, new technology could have a beneficial effect on efficiency. Efficiency would mean higher profits and, thus, a higher capacity to invest in equipment. Because the *Postal Services Act* requires the Commission to finance at least one-half of its capital investment from its own profits, this could be a spur to efficient operation.

Unfortunately the union has probably won the technology battle. Butlin, Barnard and Pincus (1982:309) describe the postal system prior to 1975 as 'technically unprogressive'. The Commission's programme of mail-sorting centralisation (and mechanisation) met with much union resistance and was eventually reversed. The Australian Federation of Consumer Organisations (1984), at the Prices Surveillance Authority Inquiry, noted that letter indexing equipment costing \$10m had been purchased almost two years previously but had never been used. This was also mentioned in a *Bulletin* article (Hope, 1985), which went on to say that 'equipment which (in [then Australia Post Chairman Doug] Rickard's terms) equates only to a slight improvement on the bow and arrow cannot be introduced' (p.92) and that 'the postal network will revert to an almost totally manual operation once decentralisation is complete, with work practices much the same as they have been for 50 years' (p. 93). Union resistance to automation of counter services also seems to underlie, in part, the suppression of the Auditor-General's efficiency audit.

Chapter 7

Evidence of Cost-Inefficiency in Australia Post

Introduction

Australian postal services once enjoyed widespread public respect. But criticism has been mounting in recent years from official and unofficial sources, including the Bradley Report, the 1984 Prices Surveillance Authority Report, a suppressed Auditor-General's efficiency audit, the Australian Federation of Consumer Organisations, and an Arbitration Commissioner. Perhaps the most damning criticism has come from within. 'Postie' Norm Southall, a former postal employee of 26 years, recently said 'I've watched an extremely efficient and reliable mail service deteriorate to what it is today, a disgracefully lazy and apathetic operation that needs to be dug up and started all over again' (*Sunday Telegraph* 9/12/84).

According to economic theory, there is no reason to expect that a publicly-owned monopoly organisation like the Australian Postal Commission will operate efficiently. This form of institutional structure provides incentives and opportunities for cost-inefficient methods, and there is very little scope for external control to be successful under such circumstances. This chapter examines the case of Australia Post.

The evidence is not encouraging. When increased productivity (although perhaps illusory), constant real labour costs and reduced services all combine to produce a rise in real postal charges, there is a strong suggestion of inefficiency. Other evidence also suggests slack operation.

Nor is the evidence conclusive, for a number of reasons. One is the lack of a point of comparison. There is no private sector coun-

terpart for more than half of Australia Post's business, and international comparisons are extremely difficult. We can track changes over time, but this only indicates whether things are getting better or worse.

Another problem is the deficiency of information provided by Australia Post. Even under extreme pressure from the Prices Surveillance Authority, the Commission has provided very few details of the results of its various trading activities. This lack of disclosure is itself evidence of inefficiency.

The Bradley Report notes that 'the provisions of the present legislation do not provide the Commission with sufficient incentive to undertake continuing assessment of the economic use of its network or individual assets within that network' (p.36). In particular, the Report draws attention to the possibility of 'the uneconomic use of prime sites in major urban areas' and resistance to 'the contracting out of counter service functions, and greater use of non-official post offices and community mail agencies in place of existing uneconomic facilities' (p.36).

The Prices Surveillance Authority's Report criticises Australia Post's inefficiency and notes that 'the postal service in New South Wales is substantially more costly than it is in other mainland states, and these extra costs are absorbed into the uniform postal rate . . . and are equivalent to about 1 cent in the postal rate for standard articles' (p.3).

These are quite serious charges and do not gel with Australia Post's claims that 'efficiency is constantly monitored by internal performance tests' and that about half of its business is 'won in the market place, against competition . . . [providing a] \$500m spur to efficiency' (*Annual Report*, 1982-83:14). However, elsewhere in the same document are hints of a less urgent attitude towards efficiency. Consider, for example, this statement: 'Australia Post is proud of the fact that, in the past, it has been able to effect significant changes to its network, operations and work practices and, at the same time, provide security of employment to staff' (p.36). Why should this be a matter of pride when viewed in the light of the Commission's statutory obligations? Postal consumers might prefer to see the Commission able to express pride in its achievement of those obligations.

There are four broad ways in which the efficiency of the postal service might be assessed. First, we examine how the price and quality of its service have changed over time. This allows us to check for an improvement or deterioration in the performance of Australia Post. Next, we compare the public postal service with the private ones in those areas where competition is allowed. That is, we seek a private sector yardstick. Third, we compare the costs and quality of our postal service with those of overseas countries. As

a final item, we include evidence from the work-place itself — details provided by a former employee of Australia Post about the normal working day of a mail carrier.

The Evidence Over Time

Consider first the real cost of a standard article's postage. Table 7.1 presents the relevant data — the nominal price of sending a standard article as of June each year, the Consumer Price Index (CPI) as of June each year, and the real price of a letter (i.e. the nominal price deflated by the CPI). The figures show that the real price of a standard letter has risen appreciably since 1974, or since the Commission was established in 1975, but that it has stayed fairly constant since 1978.

The only notable decline occurs in 1977, but this can be explained by the huge 80 per cent rise in September 1975, from 10c to 18c. In its submission to the PSA Inquiry into Postal Charges, the Department of Communications (1984) notes that the 80 per cent rise changed a loss of \$64.4m in 1974-75 to a profit of \$31.7m in 1975-76. The Department argues that the increase was more than enough to put the Australian Postal Commission on a secure financial footing. In fact, a rise of 50 per cent would have sufficed.⁴ If this rise had occurred the real price would have stood at 30.79 cents in June 1976. This adjustment is reflected in Table 7.1 by the figures in parentheses.

In its submission to the PSA Inquiry into Postal Charges, the Commission chooses 1976 as its starting point, allowing it to point to a sharp decline in real rates. While the Commission's motives are understandable, it claims incorrectly that 'Over the total period since the establishment of the Commission, the basic postal charge has increased much more slowly than any of the price indices examined below' (p.30). These all begin in 1976 but the Commission began in 1975.

Our figures show that the inflation-corrected price of a standard article has remained roughly constant since 1977. But over the same period rises in productivity and falls in service quality should have reduced the price. According to the Department of Communications, productivity rose substantially over the period of the Commission's existence. As measured by articles handled per full-

4. A little less than 50 per cent may have done the trick. The Department seems to ignore the fact that a smaller increase in price would have meant a smaller decrease in mail volume. On the other hand, under the new legislation the Commission had to provide for at least half of its investment from profits. Therefore it would have aimed to do a bit better than break-even. The balance of these considerations suggests that 15 cents was about right.

time staff member, productivity rose 33 per cent between 1975-76 and 1982-83.

Service quality has declined considerably, although this process was substantially complete by the time the Commission was established. Butlin, Barnard and Pincus (1982:331-312) note 'a progressive decline in the quality of service — in the number of post boxes, in the frequency of clearing and of delivery'. Twice daily suburban deliveries ceased in 1968 and Saturday opening of post offices in 1974. Why have these factors not been reflected in a reduction in rates in real terms?

The Prices Surveillance Authority (1984) seeks to excuse Australia Post on the basis that it is a labour-intensive organisation, the costs of which would be expected to rise as the conditions of labour improve. Unfortunately there is a fundamental flaw in this argument — real wages have not increased substantially over the last decade. So the price to consumers has not decreased in the face of productivity increases, small increases in labour costs, and reduced quality and reliability of the service. These potential consumer benefits must have gone in waste, further cross-subsidisation or a combination of the two.

TABLE 7.1
The Real Price of a Letter
1974 to 1985

Year (June)	Standard Article Rate (c)	CPI (June Qtr.)	Real Price of Standard Article (c)
1974	7	.371	18.88
1975	10	.434	23.03
1976	18 (15)	.487	36.95 (30.79)
1977	18	.553	32.56
1978	18	.596	30.19
1979	20	.649	30.82
1980	22	.719	30.62
1981	22	.782	28.13
1982	27	.866	31.17
1983	27	.963	28.04
1984	30	1.00	30.00
1985	33	1.06	31.13

Notes: The figures in parentheses indicate what would have been the case if the standard rate had risen to only 15c in September 1975 and had stayed at that level until after June 1976, but had risen to 18c before June 1977.

The 1985 figures assume a 6 per cent rise in the CPI.

Sources: Australia Post, *Annual Report*, various issues; Australian Bureau of Statistics, *Consumer Price Index*, Cat. No. 6401.

The data supporting these assertions are presented in Table 7.2 and Figure 7.1. These data give a summary history of the physical performance of the Australian Postal Commission over the period since its inception in 1975-76. The basic data are set out and sourced in Table 7.2, while the Figure graphs four series of particular interest. All series have the base 1975-76 = 100.

The line A/P in Figure 7.1 represents a crude measure of productivity: total articles carried per person engaged in providing postal services, adjusted for part-time staff. On this measure, productivity has risen by nearly 33 per cent over the nine-year period.

Whether this productivity increase was real or simply reflected reductions in the quality of service, consumers may have expected a fall in postage rates as long as rises in labour costs did not offset the rise in productivity. Australia Post itself and others, such as the PSA, have told us to expect real rate increases from a labour-intensive organisation.

What in fact happened to the real cost of labour over the period? The line RWC in Figure 7.1 charts the course of a measure of real wage costs in Australia. This index has risen by about nine per cent over this period, which is faster than other indicators of wage costs including average weekly earnings and a communications-specific index.

The above two indexes can be combined to yield a measure of the real labour cost per article carried, RWC/A. This cost has fallen by about 18 per cent over the period, suggesting that a **fall** in the level of rates could have been expected from a labour-intensive organisation experiencing a fall in labour costs.

For purposes of comparison we have also graphed the real cost of a standard letter (RCL) over the period. The series has been adjusted as suggested in the discussion of Table 7.1 — the actual rate for June 1976 has been reduced from 18 to 15 cents due to the excessiveness of the September 1975 increase. The RCL index fluctuates because of the discrete nature of rate changes but has remained roughly constant.

The apparent productivity increase has not, therefore, been passed on to postal users, but rather has been absorbed in the form of either cost-inefficiency or cross-subsidisation.

On the surface, the productivity increase over the last decade could be a sign of improved efficiency. However, it must be seen in the light of other factors. In particular, services have been progressively reduced and duties transferred from the postal service to its users. Although this would be expected to raise output per worker, we have already noted that much of this process occurred before the mid-1970s, too early to explain the apparent rise in productivity. Against this, consider the fact that Australia Post does not have much flexibility in regard to its employment levels.

TABLE 7.2
Productivity and Cost Data
1975-76 to 1983-84

	Year								
	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84
Total postal articles handled (millions) (A)	2,364	2,358	2,304	2,513	2,631	2,767	2,877	2,944	3,035
Persons engaged in providing postal services (P)	43,723	41,796	41,814	41,317	41,582	42,216	41,779	41,900	42,225
A/P — 1000s	54.07	56.42	55.10	60.82	63.27	65.68	68.86	70.26	71.88
A/P — index	100.0	104.3	101.9	112.5	117.0	121.5	127.4	129.9	132.9
Real Wage Cost (RWC)									
\$ (millions)	3,482	3,594	3,661	3,554	3,569	3,648	3,810	3,913	3,793
index	100.0	103.2	105.1	102.1	102.5	104.8	109.4	112.4	108.9
RWC/A — index	100.0	99.0	103.1	90.8	87.6	86.3	85.9	86.5	81.9
Real Cost of Letters (RCL)									
cents	30.79	32.56	30.19	30.82	30.62	28.13	31.17	28.04	30.00
index	100.0	105.7	98.1	100.1	99.4	91.4	101.2	91.1	97.4

Sources

A and P are both derived from various Australian Postal Commission *Annual Reports*. The series 'Persons engaged in providing postal services' is adjusted for part-time staff on the basis of two part-time staff equals one full-time.

Non-farm Wages, Salaries and Supplements + Payroll Tax

$$\text{RWC} = \frac{\text{Non-farm Gross Domestic Product Deflator} \times (\text{Number of Non-farm Wage and Salary Earners}) \times (\text{Average Hours Worked by Non-farm Wage and Salary Earners})}{x}$$

From the Australian Bureau of Statistics *Quarterly Estimates of National Income and Expenditure*, Cat. No. 5206, and *Labour Force*, Cat. Nos. 6203.0 and 6204.2.

RCL sources and adjustment as explained in notes to Table 7.1. The rate was taken at the end of each financial year, with a special adjustment for 1975-76.

As time proceeded, the amount of mail rose but new staff were not needed. The 'slack' created by reduced services was taken up by growth of volume rather than reduction of staff. On this view, the increase in productivity is no surprise. Perhaps the surprise is the poor productivity increase in the light of the dramatic decline in quality.

Evidence from the Private Sector

On the bulk of its business there is no way of comparing Australia Post's performance with that of the private sector because there is no private involvement in the standard mail area. Still, several classes of postal services have private competition, so it should be possible to compare rates, delivery times, guarantees, etc.

Unfortunately, comparing the rates and conditions of Australia Post to those of private courier services is not completely accurate. Even if rates and conditions are similar, the government service benefits from tax exemption and subsidisation of capital costs. Further, it can be propped up by cross-subsidisation from profitable areas protected by the monopoly. As noted in the

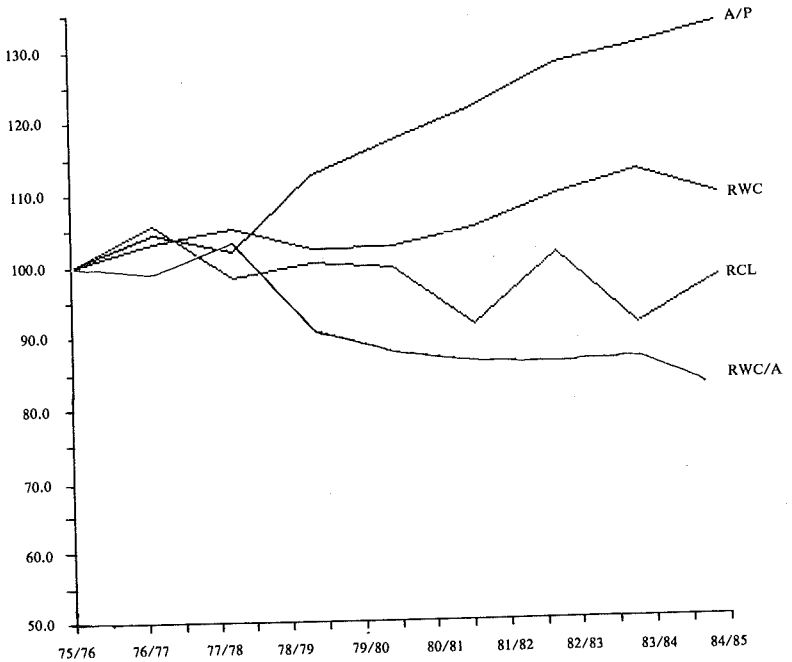


Figure 7.1: Performance of Australia Post (Index), 1975/76 — 1984/85.

Bradley Report, one of the reasons Australia Post's right to operate a courier service was terminated in June 1981 may have been that the Government perceived the Commission to be 'competing on an unfair basis' (p.26).

Chodorov (1948) was able to compare the United States postal service of nearly 40 years ago with its private sector competitors. He claims that 'where competition is allowed, its inefficiency is glaring and definitely measurable. Its parcel-post business for the fiscal year 1946 shows a loss . . . of forty-two and a half millions; its money-order business lost nearly twenty millions, . . . and postal notes lost another twenty-seven millions. Now, most of these services can be bought at comparable rates from taxpaying concerns, who seem to derive a profit . . . there is no question as to the inefficiency of the Department; it is recorded on the objective yardstick of the marketplace' (pp.15-16).

The situation in the United States is now quite different. The United States Postal Service (USPS) is no longer legally able to cross-subsidise between different classes of mail (Bovard, 1985). The parcel service still cannot compete with the private United Parcel Service, which has progressively drawn business away from the government service despite a huge investment in bulk-handling facilities by USPS. The USPS's move into electronic mail in 1983 has been making substantial losses.

Chodorov and Bovard at least had the advantage of access to the necessary statistical information to make such observations. In the Australian context a complete assessment of the situation is hampered by the way the Australian Postal Commission presents its accounts with insufficient break-up of the returns from its different activities. Separate results for its courier express service are not publicly available. We suspect, however, that the courier service does run at a loss. It offers rates that are generally favourable compared with those of private courier services, and this is not likely to be the result of greater efficiency than private operators. It may arise partly from Australia Post's cost advantages over its competitors. However, it is most likely that the express courier service is subsidised from profits elsewhere.

Evidence from Overseas

Another possibility is to compare rates, charges and conditions in Australia with those of overseas postal services. The problem with such an exercise is that all major postal services around the world are government-run monopolies. Further, some governments explicitly subsidise their postal services.

The Bradley Committee and Australia Post itself have made overseas comparisons. The Bradley Report suggests that on this basis the 'Australian Postal Commission rates well', but draws

attention to 'fundamental differences in financial arrangements ... and in operating environment' (p.47). The fact that Australia Post does well despite disadvantages of 'relatively low population density and vast distances' could be a result of 'superior efficiency which is commendable, or ... generous financial arrangements which might not be so commendable' (p.47). Australia Post itself claims that 'Postal charges are not high when compared with rates in countries where postal charges are not subsidised' (*Annual Report*, 1982-83:14).

For these reasons we will not make independent international comparisons. But we can draw a few conclusions on the basis of the evidence available. Although its rates are 'not high' compared with those in countries where charges are unsubsidised, Australia Post's charges are subsidised by the presence of two very important cost concessions. This implies that its rates do not compare favourably. Also, Bradley's 'vast distances' are not a good excuse for Australia Post. Australia is among the most highly urbanised nations on earth and the great bulk of mail movements are intra- and intermetropolitan. The rural cross-subsidy on standard mail costs only about \$30m or about seven per cent of the total costs of the standard mail service.

Evidence on the Job

Examination of the evidence suggests slackness or inefficiency in all of the major areas of postal service: sorting, counter services and delivery.

The decentralisation of mail-sorting in New South Wales has resulted in a return to the most primitive sorting technology while \$10m worth of new electronic sorting equipment lies idle. In addition, Arbitration Commissioner Grimshaw recently warned that overtime abuse at the infamous Redfern mail exchange had wasted possibly millions of dollars. The Commissioner claimed that entire shifts of workers were offered overtime regardless of the work available (Donohoe, 1985).

Counter services are a big money-waster according to a suppressed Auditor-General's report.⁵ The draft report suggests that 'savings of about \$30m a year would come from automating

5. The Auditor-General began an efficiency audit of Australia Post's counter services in 1980. Two *Bulletin* articles (Farmer, 1985a, 1985b) told of the Auditor-General's suppression of the report and summarised its findings. The long saga of the efficiency audit finally came to a head with a Public Accounts Committee investigation into why the Auditor-General had not released the report. The report became publicly available in August 1985 (through the Public Accounts Committee) and appears to be of a very high standard. The existence of an arrangement between Audit and Australia Post not to release the report remains a strong possibility.

the counter network at post offices. Some 1,150 jobs would be cut and another 1,400 transferred from official to non-official post offices' (Farmer, 1985b:29). Further savings could be made by separating counter and postman facilities. Net savings could be as high as \$30m p.a.

Perhaps the most dramatic evidence of on-the-job inefficiency comes in the area of delivery, from former postman Norm Southall. Southall 'would finish his daily 26-kilometre bike run up to three hours ahead of some posties doing their runs on motorcycles' (*Canberra Times* 10/1/85, p.9). Was this a result of Postie Norm's above-normal performance, or the slackness of his work-mates? Figures in the 1983-84 *Annual Report* throw some light on this issue.

In 1983-84 there were 7,280 full-time staff described as belonging to the 'Postman Group'. A rough allowance for recreation leave, overseers, etc., reduces this figure to 6,500. Netting out private boxes, etc., these posties deliver to about 5 million delivery points. This represents 769 delivery points per postman. About 3 billion articles moved through the mail system, not all of them being delivered to street/roadside locations. Assuming that all were so delivered, over a 250-day period each postie delivers an average of 1,846 articles per day. Assuming he or she visits every delivery point every day, the average postie delivers 2.4 articles to 769 delivery points per day.

Suppose it takes six minutes to deliver to 20 locations. This does not seem unreasonable on the basis of my own experiments with a push-bike in suburban Canberra. At this rate, the postie's round would be completed in about three hours 50 minutes. Add to this a generous allowance of 30 minutes to get from the post office to the round and back, and we have accounted for not much more than one-half of the working day — or about the time it took Postie Norm to finish his round.

This estimate has been based entirely on conservative assumptions, including that every delivery point is visited each day. The most debatable assumption is that of the delivery rate. Those who doubt it should try the 'push-bike test' for themselves.

To the extent that this estimate is correct, it suggests that the Australian Postal Commission could economise greatly on its staff if they all worked as well as Norm Southall did.

Chapter 8

Industrial Blackmail

Introduction

Australia Post's poor record of industrial disputes is no secret. Consumers of postal services have paid dearly for the maintenance of its exclusive rights to carry the mail. Disruptions have increased in the last several years after a period of relative calm. Whatever the basic cause, this must become a matter for serious consideration by the Federal Government, which has so far adopted a detached attitude to the 'industrial blackmail' that has been occurring.

Australia Post's exclusive trading powers are at least part of the reason for the industrial disharmony that plagues our postal service. When a public firm has monopoly power in the supply of a commodity, it confers an element of monopoly power on unionised labour as well. Exercise of this monopoly power may manifest itself in industrial disputation and consequent disruptions in service to the public.

One way of thinking of the industrial relations situation is to assume that the amount of potential monopoly rent is fixed by extraneous factors of demand and actual justifiable costs of operation, and that management and unions squabble over the spoils (i.e. the implicit profits) in a 'bilateral monopoly' situation. The results of such bilateral bargaining are usually thought to be inconclusive.

Another approach is to assume that price and quality of service are adjustable to some extent, such that excessive wage costs and the costs of slack working conditions can be passed on to

consumers in the form of higher prices and/or lower quality of service. This is the view expressed by the Bradley Committee.

In either circumstance one would expect to see union activity aimed at establishing better wages and conditions. However, the response of management may be different in each case.

In this chapter we look at the recent history of industrial disputes in the Australian postal service and then examine possible reasons why the postal unions are so active.

A History of Problems

Historically the post office has offered good conditions of service and has made attractive deals with its staff. Butlin, Barnard and Pincus (1982:313) refer to sweetheart arrangements in the early years and note that after 1945 'the wage level in communications . . . rose faster than in other industries, reflecting the upgrading of skills as well as a cosy relationship between employer and unions'.

This comment refers to the time when the postal and telecommunications services were combined under the Australian Post Office. It may, in fact, be directed more at telecommunications than the postal service. The common conception has been that the postal services have displayed considerable disharmony in industrial relations, especially since the advent of the infamous Redfern Mail Exchange during the 1960s.

However, according to the Commission of Enquiry (1974), the industrial relations scene was not exceptionally bad. The Vernon Report claims that the 'industrial record of the A.P.O. in terms of manhours lost per 1,000 employees has been generally better than that of Australia as a whole in recent years' (p.131), although it does refer to black bans at the Sydney Central Mail Exchange having serious effects on the standard of mail delivery in New South Wales (pp.70, 131) and to the possible inadequacy of 'manhours lost' as a measure of industrial disputation (p.131).

In fact, 'manhours lost' is a completely inadequate measure of industrial action in postal services. Apart from some very visible strikes, the most common form of postal dispute does not show up in the figures at all. Both then and now, 'work bans' — involving workers reporting for work but failing to perform certain duties — have characterised industrial disputes in the postal industry. It is noteworthy, however, that work bans went out of fashion in the late 1970s and early 1980s when, under the *Public Service and Statutory Authorities (PSSA) Act*, they led to cessation of wage payments.

Since the Commission of Enquiry reported in 1974, Australia Post has pursued a programme of decentralising mail exchanges, possibly aimed at reducing the amount of disputation in the long

term. By splitting the workers up, decentralisation might be expected to make it more difficult to organise industrial disputes.

These views have been expressed by Australia Post's then Chairman, Doug Rickard. In a recent *Bulletin* article (Hope, 1985:91) he is quoted as saying 'Redfern was a dreadful mistake, a technocratic blunder. The alienation that resulted from 3,500 people working under one roof, together with the power play and militancy that developed among the 20 or so unions on site, have left lasting scars on both sides. We are witnessing a Custer's Last Stand over Redfern ...'

At first the decentralisation programme did seem to reduce disputation. The brave move seemed to be paying off. But in retrospect, the period of calm was probably more a consequence of the *PSSA Act*, which operated from 1980 to 1983, than of decentralisation. This Act was in force during the major period of decentralisation; when it was repealed we observed 'Custer's Last Stand'.

The Bradley Committee examined the postal service during this period of industrial peace, a factor which may have contributed to its conclusions in favour of Australia Post. Unlike the Vernon Report, the Bradley Report has little to say about industrial disputation. It does, however, refer to complaints about industrial disputes in some of the submissions. The Committee also has industrial disputation in mind when it states that 'as a matter of principle, if the monopoly supplier is unable for whatever reason to service the genuine needs of the community, the law should not prohibit the community from pursuing its interests through reasonable alternative avenues' (p.49).⁶

The Bradley Committee is not prepared to accept Commission and union suggestions of greater flexibility in industrial relations, as it feels that Australia Post 'by virtue of its limited statutory monopoly ... would be cushioned to some extent from the effects of acceding to excessive wage claims, etc.' (p.75).

As we have noted, the industrial scene has again become tumultuous, especially in New South Wales. Nineteen eighty-four was a very bad year for mail movements into and out of Sydney. The extent of the difficulties was highlighted by a number of witnesses at the 1984 Prices Surveillance Authority Inquiry. The Australian Direct Mailers Association, the Australian Federation of Consumer Organisations, and Reader's Digest were prominent among those lamenting the sorry state of the mail services in New South Wales. A major submission on this matter to the Minister for Communica-

6. The Government did not incorporate this recommendation in its revisions to the *Postal Services Act* in late 1983. It did, however, accept one other of Bradley's recommended exemptions.

tions, Mr Duffy, from the Direct Mailers was completely ignored (or perhaps the reply was lost in the mail?).

The trouble has continued in 1985 with delivery standards in New South Wales still well below those achieved in other states, and significantly below acceptable levels. Australia Post, bewildered by the continued industrial disputation, despite decentralisation and improved staff amenities, has had stand-down clauses inserted in its workers' awards.

The Simple Solution

Australia Post has been unable to find an answer to its current predicament. The trouble in New South Wales has shown no signs of abating — if anything it has escalated. The quality of the service has deteriorated markedly and many users seem to be losing faith in the postal system. Australia Post has promised improvement but has not been able to deliver. The Federal Government has not seen fit to intervene.

The disputes affecting the New South Wales operations are often over trivial issues like biting insects, lack of air conditioning and alleged security weaknesses. They often take the form of bans rather than strikes. Workers continue to be paid even though they do not work as directed. Australia Post has blamed the upsurge in disputation on the Federal Government's repeal of the *PSSA Act*, which had allowed public sector employers not to pay their employees if they did not work as directed. The then Deputy Opposition Leader, Mr Howard, has also blamed the repeal of this legislation. Australia Post has even sought to insert *PSSA*-type provisions in the industrial awards of its employees.

While it is clear why Australia Post would seek to blame its industrial troubles on the repeal of the *PSSA Act*, it is less obvious why Mr Howard would highlight this cause. There is no doubt that this Act reduced work bans by postal workers, but can all the recent problems be blamed on its repeal? Is there a more fundamental cause of industrial unrest in the postal industry?

The Liberal and National Parties have failed to grasp the true reason for our postal ills. In their Communications Policy, released prior to the 1984 election, the coalition parties saw the solution to the problems in terms of greater external controls. As argued in the next chapter, this is not the answer. The simple solution to problems of industrial unrest and inefficiency in the postal system lies in the competitive marketplace, not in further manipulation of the monopoly.

Australian political leaders have not embraced this solution to industrial disputation, but British Prime Minister Mrs Thatcher certainly has. In response to worker bans on electronic sorting

equipment and the employment of casuals, Mrs Thatcher has threatened to remove the postal monopoly (*Australian*, 6/7-4-85). If she carries out her threat it will set an interesting precedent.

At the very least the *Postal Services Act* should be amended to oblige the Minister to suspend Australia Post's monopoly whenever mail movements are disrupted by any industrial dispute. Australia Post's monopoly is sometimes defended on the grounds that it provides a vital service that should not be subjected to the vagaries of competition. But what about the vagaries of the postal unions?

Chapter 9

Can the Recommendations Work?

Introduction

The standard response to perceived problems in the postal system is more government regulation designed to force the public monopoly to behave in a more socially desirable manner. This has been a feature of all official enquiries into the Australian postal system from the first (which reported in 1911) to the last (in 1982). None have seriously questioned the basic assumptions of public ownership and legislated monopoly power.

This chapter concentrates on the two most recent official reports on the Australian postal system. These reports (of 1974 and 1982) take the standard approach of attempting to tame the beast by changing its structure and control. Their recommendations are reviewed and analysed to see whether the desired improvements actually result from the changes.

The Commission of Enquiry into the Australian Post Office (1974) is likened by Singleton and Howard (1977:197) to 'the drunk who lost twenty cents in a dark street. Rather than hunt about for it in the dark he moved on up the street and proceeded to look for it under the street light . . .'. In this chapter it is argued that the major result of this enquiry — changing the status of the postal system from departmental control to a semi-government authority and separating it from telecommunications — has not been very useful in making the postal system efficient. This administrative change, which was recommended as early as 1911, is but a very small step in the right direction.

The previous Government may have been expecting some non-traditional recommendations when it set up a Committee of

Inquiry into the Monopoly Position of the Australian Postal Commission. The Committee's name certainly suggests a fresh approach. But it too is 'satisfied that the present monopoly . . . in the carriage of letters should be continued with some relatively minor changes' (p.77). This conclusion is not based on natural monopoly grounds (p.41), nor for that matter on any logical economic grounds. The Committee sees some merit in politicised pricing and is very concerned with the question of financial viability. Having accepted the continuation of the public postal monopoly, the Committee makes a number of recommendations aimed at regulating its behaviour — the traditional naive approach of attempting to tame the savage beast.

Creation of a Semi-Government Postal Service (The Vernon Report)

The transformation of the postal system from part of a government department encompassing both it and the telecommunications service to a semi-government 'commission' (the Australian Postal Commission) operating only the postal services was the principal achievement of the 1974 Vernon Report.

The organisational changes suggested and accepted have made no substantial difference to the efficiency of the service. The Australian Postal Commission remains a government agency. It also maintains its monopoly position and operates under conditions similar to those previously prevailing.

There are, however, a couple of differences. Perhaps the most important of these is that the postal service has to cover its costs of operation, even if on favourable terms (including concessional capital costs and the absence of taxation). This it had not been doing in most of the post-war period. The division of the old Australian Post Office also meant that cross-subsidisation between telephonic and postal communications became virtually impossible.

The first of these changes, a requirement to cover costs actually incurred, is no guarantee of cost efficiency, especially when relevant economic costs are excluded from the definition of costs. The postal system still has considerable scope for cost-padding. It is also worth remembering that there is no real punishment that can be meted out if the Commission fails to meet its cost covering requirement.

On the second issue it must be pointed out that Australia Post has maintained and continues to use significant avenues for cross-subsidisation (especially between urban and rural users) even though one major cross-subsidisation opportunity (between telephone and postal services) has been removed. This must be seen as

a significant achievement of the Vernon Report, especially in light of the large amount of cross-subsidisation that had been occurring.

The Vernon Commission did not confront the really important questions of the statutory monopoly and its associated ability to cross-subsidise. It accepted implicitly the continuation of exclusive trading powers and mentioned the cross-subsidisation issue only briefly. It did, however, raise the question of subsidising loss-making activities from the Budget rather than from higher charges on other users.

The Vernon Commission was looking for solutions within the confines of public ownership and monopoly rather than examining the validity of the assumptions underlying public ownership.

Financial Targets and Other Controls (The Bradley Report)

The strongest chance for radical change was presented by the Ministerial Review of Commonwealth Functions (the 'Razor Gang'), which, among other things, set up the Bradley Committee of Inquiry to examine the monopoly position of the post office. The Razor Gang seemed to mean business and gave some indication of its toughness by ordering the immediate abolition of Australia Post Courier. There was reason to believe that the Bradley Committee's Report would depart from the conventional mould. Two members of the three-person Committee were from the business community and the terms of reference gave plenty of scope to recommend significant changes.

The Razor Gang may have been a little disappointed in the Bradley Report. The Report recommends retaining Australia Post's letter monopoly and goes against the decision to discontinue Australia Post Courier. However the Bradley Committee does make some suggestions that would improve the system, if only marginally.

In regard to the letter monopoly the Committee recommends 'that, as a matter of principle, the exclusive power of the Australian Postal Commission to carry letters for reward be continued' (p.77). However there are some qualifications. Letters carried for a charge of \$2 (the amount to be indexed) or more would be exempted; the Minister could suspend the monopoly where Australia Post 'is unable to provide a service' (p.78); certain intraorganisation mail would be exempted; and the monopoly would not be extended to electronic mail. The Committee does, however, alert the Government to the potential threat to the monopoly posed by electronic mail communications.

Cross-subsidisation of rural users would continue 'as according with the Commission's statutory obligation to have special regard

for the needs . . . of people . . . outside the cities' (p.46). In regard to registered publications the Committee suggests that the Government 'review and clarify the objectives of the concession' and that the Commission should 'receive Budget subsidies' to cover the cost of the concession (p.79).

The Committee's most detailed recommendations are in regard to Australia Post's financial arrangements and capital structure. As discussed in Chapter 6, the Australian Postal Commission would be required to pay a target rate of return after interest and income taxation. Because of Australia Post's public service obligations, the Committee recommends that 'the rates of return on assets . . . be set separately for the standard article service . . . and . . . other services' (p.56).⁷ The Committee also suggests that the Commission no longer be exempted from taxes at all levels.

The Committee is certainly on the right track with these recommendations, but exposing Australia Post to taxation and setting financial targets are far from the complete answer. They still do not get to the root of the problem: the existence of public ownership and monopoly power.

The requirement to pay taxes at all levels will impose some discipline on the Commission. It will be that little bit harder to cover costs **and** provide perquisites and an easy life for management and staff. Some of the potential profits that are now wasted through cost inefficiency would be diverted back to the public purse in the form of taxation revenue.

The other suggested financial reform — meeting a specified financial rate of return — also reduces the scope for cost-padding, but it is only a step. As long as monopoly power remains and the enterprise strives to maximise cost-inefficiency, financial targets can turn only some implicit profits into explicit ones. Officer (1983:47-48) is not convinced that a target rate of return is the way to make public enterprises efficient because it is 'residually imputed and the enterprise has the potential power to manipulate resources to achieve the standard'.

Where both cost inefficiency and size are important to the enterprise the effect of financial targetting is difficult to predict, although it might be expected to reduce output and raise price (the bad news) while reducing cost inefficiency (the good news). This prediction is very tentative and financial targetting is not

7. Officer (1983:51) suggests another way of dealing with the community service obligation. The value of the service 'should be added back to earnings . . . and should be highlighted in the performance evaluation as the government's estimate of the minimum value of the public benefit (positive externality) . . .'. This approach seems superior to Bradley's.

necessarily in the public interest. This question is discussed in more detail in Albon (1985b).

Officer argues for the greater use of true 'value-for-money audits' as a means of making state enterprises behave in the public interest. Such efficiency audits are **not** among the Bradley recommendations. However there are problems with such audits including the 'potential embarrassment that such an audit can cause to the enterprise, the administering department and the government [which] is probably also a factor inhibiting [their] greater use ...' (Officer, 1983:48). The bottom line in Officer's appraisal is the same as in this study. Value-for-money audits of the public monopoly may be a good idea but they are not really the answer. The best prospect for reform lies in the creation of a 'contestable market environment ... [which] would involve either returning the enterprise to the private sector or allowing the private sector to compete with the state enterprise' (p.57).

The Committee makes another important recommendation regarding superannuation. The *Postal Services Act* obliges the Commission to participate in the Commonwealth Superannuation Scheme rather than operating its own scheme. The Committee feels that this puts the Commission at a disadvantage compared with the private sector. 'Postal Commission employees ... receive very favourable rates of benefits compared with what might be expected in the private sector' (p.62). The Committee recommends that the Postal Commission establish a separate superannuation scheme that would be compulsory for new employees and available as a once-only transfer option to existing employees.

Australia Post (1984) has suggested that the Commonwealth Superannuation Scheme costs it about \$60m more than would a private scheme. While this claim may be exaggerated it is clear that the superannuation scheme is a cost disadvantage to Australia Post that ought to be removed. It also stands as a major obstacle to reform (as does that of Trans Australian Airlines in regard to the regulation of domestic airline operations). The recommendations of Bradley in this regard can only be endorsed wholeheartedly.

The Bradley Report does not endorse the Razor Gang's decision to terminate Australia Post's courier operation. The Report recommends that Australia Post be 'authorised to operate a postal courier service as part of a comprehensive postal network' (p.77). It also recommends that Australia Post be able to involve itself in electronic mail transmission, but not as a monopolist. This important question is discussed further in the next chapter. Finally the Committee recommends that the Commission's business practices in various areas including leasing, employment, land transactions and capital works be free from government interference. Acceptance of these recommendations would probably mean a net

improvement in the postal service, but it would still not solve the basic problems caused by lack of competition and public ownership. A public monopoly cannot be disciplined sufficiently by financial targets and other controls.

The fate of the Bradley Report is not clear. The Government that set up the Committee did not have time to act upon it before losing office early in 1983. The present Federal Government announced some changes to its postal legislation in late 1983 and is currently working on the financial aspects of the Postal Commission's structure. Financial reforms along the lines of the Bradley Report may be expected. The Federal Government appears to have embraced the concept of financial targetting as a solution to the public enterprise problem.

Amendments to the *Postal Services Act* came into force in late 1983. The Commission was again empowered to operate a courier service, which could pick up and deliver articles without the conduit of a post office. The Commission was given an entitlement to operate electronic mail services where consent has been given by Telecom (for internal transmission) and the Overseas Telecommunications Commission (for overseas transmission). The Act was also amended in regard to the s.85 monopoly provisions. In the spirit of Bradley's exemption of articles carried for \$2 or more (indexed), the Act now exempts articles 'where the consideration payable for that carriage or conveyance is an amount that is not less than 10 times the highest postal applicable' if carried by Australia Post.

These amendments — and those that may arise as a consequence of the current investigation of appropriate financial and capital structure matters — are hardly the basis for rejoicing. The monopoly remains basically untouched so that there is no context for meaningful improvement in the Australian postal service.

Price Surveillance — Another Band-Aid

While cost control has not been prominent in the current debate on public monopolies, the option of price surveillance has been discussed. This is yet another instance of tinkering with a basically unsound system. While price control, efficiency auditing, and financial targets may improve the behaviour of public monopolies, they can never be a complete solution.⁸

8. In the simple monopoly model we have been considering price control does result in social gains. However holding the price below the monopoly level could have some adverse consequences. In particular it could lower the quality of service and create nonprice rationing of service. This result is explained in the sophisticated analysis of public utility control by Hartley and Trengove (1983).

The Inter-Departmental Committee looking at financial controls for Australia Post has been overwhelmed to some extent by a broader investigation of financial aspects of the operation of statutory authorities in general. Partly as a consequence of this process Australia Post has been placed under the scrutiny of the new Prices Surveillance Authority.

As noted in Chapter 3, Australia Post has not had complete control over pricing. The Minister had to approve any rate changes and there is some evidence that he was not always permissive in this regard. Major rate increases tended to follow elections, even though large increases often reflected an element of catching-up. The Minister could not be too obstructive in light of the Commission's obligation to cover its costs each year.

The procedure is now more formal. The PSA must be notified of the Commission's intention to vary its rates on standard articles and registered publications. It may scrutinise the proposed rates internally, or it may, at the request of the Treasurer, subject them to a public inquiry. Such an inquiry would force Australia Post to reveal a lot more detail about its internal operations. The PSA does, nonetheless, have difficulties in determining appropriate rates on the bases of costs because of the joint costs problem.

In 1984 the Commission notified the Authority of a decision to raise the standard postage rate by ten per cent (from 30 cents to 33 cents) and registered publications rates by an average of about 20 per cent. The Treasurer ordered a public inquiry. This inquiry was held in October 1984 and elicited a large number of submissions, some of which have been mentioned elsewhere in this monograph.

The PSA's Report (1984) is a considerable disappointment. It made some minor criticisms of the Commission (particularly in regard to its operations in New South Wales) but concentrated its attention on cost **increases** rather than the underlying level of costs. On the basis of the projected cost increases the Authority viewed the notified rate increases as substantially justified and recommended that the standard letter rate rise to 33c but that the weighted average registered publications rise be trimmed back to 15 per cent. In so doing the PSA managed to grant an increase in the cost of an already profitable service and trim back the increase in one that appears to run at a substantial loss.

On the more encouraging side, the Authority did criticise the Commission's degree of disclosure and its cost allocation procedures. It called for formal investment analysis of Australia Post projects and expressed concern about 'the need to ensure that costs are not inflated' (p.3). It noted that the postal service in New South Wales is substantially more costly than it is in other mainland states, and estimated that these extra costs add about one cent to the uniform postal rate (p.3). The PSA also asked to be directed

to scrutinise the Commission's policy of uniform pricing and thought that the 'whole basis of the registered publications service' (p.5) should be reviewed.

Chapter 10

A Competitive Private Postal System

Introduction

Traditional ways of controlling state enterprises like Australia Post do not work. The basic problems lie in the existence of monopoly power protected by the state and in state ownership itself. If these factors are accepted as given, the prospects of establishing an efficient and equitable postal system are not good.

At the very least the government should do nothing to suppress the competitive forces already at work in the postal industry. These forces — including electronic mail transmission, private couriers and the document exchange system — could substantially reduce the sting of monopoly. This is the weak *laissez-faire* approach, which could be coupled with some other changes that would free Australia Post from its public service obligations and do away with its present substantial cost concessions.

A more radical approach would be to unleash completely the forces of competition by removing Australia Post's statutory monopoly. This is the strong *laissez-faire* approach, and it deserves more serious consideration than it has received in the past.

For the full competitive policy to be completely successful the government will probably have to get out of the area altogether. Despite its natural advantages a public enterprise may not be able to survive in a competitive environment, and the Government may be tempted to subsidise it. This would rob the public of some of the potential gains from competition.

Finally, this chapter attempts to describe how a competitive postal system might work, particularly in regard to private networking and the likely costs of various postal services.

Using Competitive Forces

Sending a letter is no longer the only way to transmit written communications. The services provided by the Australian Postal Commission, while an extremely important part of the industry, are being challenged by a host of rival services including sophisticated electronic mail transmission, private courier services, document exchange and various transport operations. It is very important that these forces are not suppressed by government control and are used in a way that will ultimately give Australia an efficient postal system. Australia Post is acutely aware of these competitive forces and has devoted some of its energies to a political rather than a market response to them.

Electronic mail itself is not new; it has been with us since the advent of the telegraph. What is new is the way technology has reduced the cost of electronic mail and given us a broad array of ways to communicate. Acceptance of electronic mail has so far been slow, both here and abroad. Will this transition quicken or will there still be a place for the traditional 'postie' for many years to come?

Opinions about the future of electronic mail transmission vary. Some observers believe that unless the Commission's monopoly is extended to cover electronic mail communications, the traditional letter monopoly will eventually become irrelevant. While this would be seen by many as a desirable outcome, Australia's regulatory history has usually been to extend monopoly to include new means of communication.

In its 1980-81 *Annual Report* the Australian Postal Commission was nervous about both the (then) forthcoming Bradley Report on its monopoly position and the 'possible impact of indirect competition in the newer forms of electronically-based communications' (p.40). In the 1981-82 *Annual Report* the Commission breathed a sigh of relief over the outcome of the Bradley Report, mentioning the electronic mail issue only briefly. However, the 1982-83 *Annual Report* contains a full page history and prospectus of the electronic mail question outlining how Australia Post 'is actively working to take advantage of . . . new possibilities in electronic transmission of mail' (p.42). Amendments to the *Postal Services Act* in late 1983 gave Australia Post the green light for major activity in the electronic mail area. The Commission responded by setting up its Intelpost facsimile service in 1984.

Australia Post has also come under increasing competitive pressure from private courier services. This competition is felt mainly in the non-standard articles category but also seems to be affecting standard mail. According to the United Kingdom's Post Office Review Committee (1977) this competition has taken away some of

Australia Post's profitable traffic. The Committee claims: 'The postal monopoly allows the existence of a universal system which is in the public interest, and it is not to the general advantage to allow the "creaming off" of selected profitable traffic, as has occurred in Australia by the development of courier services between the main cities' (p.71). Australia's Bradley Committee claims that private couriers may actually have 'illegally' carried certain items although, as we have seen, the legislation in the *Postal Services Act* is vague as it does not define a 'letter'.

The document exchange system is another source of competition. This system was set up initially for the transfer of legal documents between barristers' and solicitors' offices. Others (such as local councils) have since joined this expanding network which, like many courier operations, engages in activities of dubious legality under the *Postal Services Act*. It is evidence of a weak *laissez-faire* approach that no prosecutions under s.85 have been made or threatened. There are a number of other forces of competition that have the potential to erode Australia Post's monopoly. The Bradley Committee mentions 'airline companies, State and national rail authorities and transport companies' (p.17).

Australia Post is obviously worried about this competition and devotes considerable effort to justifying its monopoly position. In its 1982-83 *Annual Report*, in addition to the material on electronic mail mentioned above, there is a full-page defence of the postal monopoly (p.14). While it 'certainly does not quibble with the idea that competition can be a spur to efficiency', it does note factors such as 'internal performance tests', competition on many services, a 'positive approach to innovation' and comparable postal charges in areas where it has private competition. It also emphasises the need to maintain a national postal system, which it claims would survive only with large subsidisation (\$125 million in 1982-83) if the monopoly were removed.

The fact that competitive forces do exist means that the Australian Government can pursue the weak *laissez-faire* approach by simply doing nothing more to protect Australia Post. Significant social gains can be assured, but only if Government resists the temptation to extend the monopoly power of the public enterprise.

The government could enhance the gains from this approach by making some additional changes to the way the postal system operates. The following steps have been implied by previous discussions:

- Adopt the Bradley proposals on financial structure and regulation to place the Commission on the same cost basis as private firms. This would involve removing the taxation and cost of capital advantages and the superannuation disadvantage.

- Require Australia Post to disclose full details of its overall financial performance and of each of its areas of operation. This information should be published in the *Annual Report* with details on how joint costs have been allocated in making up the figures.
- Require Australia Post to cover its costs of operation in each service category, as well as overall.
- Introduce all the exceptions to the monopoly (including its suspension during industrial disputation) recommended in the Bradley Report, and perhaps some further exceptions as well.
- Require Australia Post to adopt a cost-related multiple rate structure for standard mail as a statutory obligation.
- Direct the Commission to use private contractors on a far greater scale in areas ranging from counter services (including sale of stamps) to the carriage and sorting of mail. As Bovard (1985:17) has said in regard to the United States Postal Service, 'If Congress will not repeal the monopoly, the U.S. Postal Service should contract with private companies to sort and deliver America's mail'.

While this set of measures would considerably improve Australia's postal service, it is not the total answer. Full gains can be realised only with a complete *laissez-faire* approach. This would, of course, mean removing the statutory monopoly now enjoyed by Australia Post.

Privatisation

The word 'privatisation' has recently crept into discussions of public enterprise policy. It literally means the transfer of ownership of a public enterprise to private hands. Littlechild has examined the privatisation issue in regard to the British Government's programme of deregulating nationalised industries. Writing specifically about this experience, Littlechild (1983:28) notes that the 'policy of privatisation . . . has three main components: changes in the organisational structure of the industry (mainly by splitting up the industry), allowing the entry of new competition, and transferring organisations wholly or partially to private ownership'.

The simple transfer of ownership, on its own, may not be very effective in attaining efficiency gains. This point was made by some commentators about proposals to sell the government-owned airline, Trans Australian Airlines. Without concurrently removing the infamous Two-Airline Policy the move could be of little social value — although such a sale may be a necessary precondition to deregulation.⁹

9. According to Kirby (1981:47) 'rather than being an irrelevant issue, the state ownership of TAA is a crucial political obstacle to open market competition in Australia's civil aviation industry'.

Siebert (1985) also emphasises the importance of ownership in his discussion of the sale of British Telecom. The concentration of ownership gives owners an incentive to monitor the performance of management. Further, shares with observable values act as a measuring rod of management quality. Therefore the ownership question may well be important even without competition.

According to Littlechild, the major achievements of British privatisation are the splitting of the Post Office and British Telecom and the relaxation of entry to postal services. He writes that the 'Post Office is reported to be increasingly efficient; its independence of British Telecom and the increased competition from couriers and electronic mail are surely important contributory factors' (1983:28-29). The recent sale of 50 per cent of British Telecom is a further step in this direction.

Littlechild argues that 'competition alone is insufficient' (p.28) to discipline an organisation because government can still prop up a public agency via subsidisation so that it can survive in a competitive environment. If a competitive postal environment were created with the Australian Postal Commission as part of it, and if that Commission were to receive significant government subsidisation, the issue of sale would become vital.

If the Bradley Committee had recommended removal of the monopoly and if the Government had accepted this advice, Australia Post would have argued for protection of the Australia-wide postal service. While it was collecting evidence, 'the Chairman [of the Australian Postal Commission] told the [Bradley] Committee that the real justification for the postal monopoly is to sustain a basic national postal network ... [W]ithout the monopoly [this] would require a massive subsidy, estimated to be of the order of \$125 million annually in 1982/83' (*Annual Report* 1981-82:19).

This claim makes a number of implicit assumptions. For example, it assumes that no private operators would take over parts of the service. It also seems to assume that a uniform standard postage rate would continue to apply.¹⁰ Nevertheless, it does illustrate a possible consequence of competition without privatisation and adds weight to Littlechild's appeal for removal of both the monopoly and public ownership.

10. In the 1982-83 *Annual Report* the Commission argues that removal of the monopoly would lead to disappearance of the Australia-wide basic postage rate, 'charges on some routes would have to be reduced ... but many others ... would have to be raised' (p.14).

The Profile of a Competitive Environment

Economists have believed in the market system as an efficient means of allocating resources since at least the time of Adam Smith. Smith wrote of the 'private interests and passions of men' resulting in a 'socially agreeable outcome' through the agency of the 'invisible hand'. There are times, of course, when competition is not optimal. These exceptions were recognised by Smith and have received much attention in the ensuing 200 years. We contend that the postal industry does not constitute such an exception. The arguments for both monopoly and public ownership have been reviewed and found wanting.

But this is not enough. We must also describe how a competitive postal system would actually operate. There is a difference between the theoretical optimality of competition and the actuality. Unfortunately it is impossible to be precise about the outcome of unleashing competitive forces where they are currently suppressed. We can only speculate, but we present the following scenario with some confidence.

The role of the Australian Postal Commission in a competitive environment requires some explanation. The Commission would be completely independent. It would not be required to maintain a national network, and it would not be obliged to maintain a uniform standard postage rate. The registered publications concession would also disappear. The Commission would simply be instructed to operate whichever postal services it desired, charge whatever rates it liked, hire and fire as it pleased, etc. It would be disentangled from the Commonwealth Superannuation Scheme. It would, however, be publicly owned, which might create some problems in defining its financial structure and obligations. If it could survive under these circumstances, well and good. If not it would not matter very much.

Australia Post would probably retain its standard mail service. This aspect of its operations is profitable already. Loss-making activities would definitely go unless Australia Post could operate them so as to cover their full economic costs. The dearth of information about the Commission's activities does not allow us to predict accurately which services would go, but all loss-making areas would certainly be at risk.

Consider standard mail more carefully. Concern has been expressed that private firms would 'skim' the profitable bits of the standard mail area, leaving Australia Post with only the loss-making segments. This may be true, but remember that Australia Post would be able to charge what it liked for its services so they would not have to be loss-making. Also remember that the Commission has an advantage over potential competitors in its

well-established network for handling standard mail. Given these factors, and the fact that the rural cross-subsidy is only \$30m out of a total standard mail business of over \$400m, Australia Post's claim that it would require a \$125m subsidy is absurd.

Others have been worried that unless there is a comprehensive public postal network some people will not get their mail. We have already concluded in Chapter 4 that the prospects for private national networking in the absence of a public system are good. A private national network of some kind will arise in response to the demand for it. This network would almost certainly involve more than one carrier, although not necessarily in all areas.

Others — particularly the beneficiaries of cross-subsidisation — may be worried about the costs of the competitive system. **Average** costs of postal services would undoubtedly fall, but a minority of users would probably have to pay more. Winners would be those who currently pay for the cross-subsidies. Their rates would fall at least three cents on standard letters as a consequence of removing the urban-to-rural cross-subsidy, perhaps two additional cents because of doing away with the registered publications concession, and a further amount because of not having to endure the general cost-inefficiency of Australia Post.¹¹ Other users, especially those in rural areas, would have to pay considerably more, although the amount of the increase would be offset by access to carriers who operate at costs below that of the monopolised Australia Post. The structure of rates in a competitive environment would vary greatly both across services and across carriers.

Of course, the government might decide not to exit the area completely, but rather to maintain some form of subsidisation of rural users. The means available to do this have been discussed in Chapter 5. The best of these, from the viewpoint of a pro-market government, is the revenue surcharge method. This would allow maximum efficiency gains while preserving the pre-deregulation pattern of cross-subsidisation.

11. Offsetting the removal of cost-inefficiency would be a requirement that the Australian Postal Commission pay taxes and meet its full costs of capital. The net effect is, therefore, difficult to determine.

Chapter 11

Politics of Postal Monopolies

Introduction

A striking feature of postal systems around the world, including Australia's, is the durability of public ownership, the letter monopoly and cross-subsidisation. The Razor Gang's intention to reform the postal service was thwarted by its own creation, the Bradley Committee, which effectively recommended maintenance of the *status quo* in regard to these three features.

Australia Post has not served the Australian public well. It has expended much effort in attempting to maintain and extend its privileges to the detriment of all but some special interest groups. Consumers of postal services have had a lot to put up with. All users have suffered from the general inefficiency of a public monopoly not subject to the disciplinary pressures of competition and private ownership. Costs are unnecessarily high, technological change has been slow, and industrial disputes (in the form of strikes and black bans) are encouraged by the present system. Only some sectional interests have gained by being at the right end of the cross-subsidisation process.

The thrust of the argument in this monograph is that attempts to tame the monopoly beast are unlikely to have substantial effects on the efficiency of the system. Fundamental changes are required, involving the opening up of competition and, perhaps, privatisation. These radical changes represent a major departure from the tired old proposals of the past. They involve stepping on some toes, which will lead to loud screams of protest. Nevertheless the great majority of Australians would benefit from a competitive postal system.

This chapter begins with a discussion of the political obstacles to reform of the postal service. The source of these obstacles can easily be ascertained by examining who would lose and gain from the marketisation of the mail. After reviewing these stumbling blocks we set out some strategies for reform that could be used by a government wishing to have an efficient and fair postal system at the least political cost. Unfortunately none of the major parties aspiring to govern Australia display any obvious penchant for marketisation or privatisation of Australia's postal services.

Forces of Resistance in Australia

A number of observers have commented on the political difficulties of meaningful policy change. Various writers including Senior (1983), Goodman and Dolan (1979), Chodorov (1948) and Friedman (1975) have analysed the political prospects of reforming public postal monopolies and all have been very pessimistic. Friedman notes that 'strong pressure groups [e.g. postal unions] will oppose changing present arrangements' while 'no strong pressure groups will favour the proposed changes — which serve only the widespread general interest of the public . . . Many citizens regard it as a paradox that a democratic government, supposed to promote the general welfare, should enact so many measures that promote special interests. It is no paradox. It is the result to be expected when government engages in activities that have concentrated effects on small groups and widely diffused effects on the rest of the citizens' (p.289). The outlook for radical change is, therefore, not good.

In Australia the major interest groups who benefit from the maintenance of the *status quo* are those who gain from cross-subsidisation (i.e. rural interests and receivers and senders of registered publications) and the management and staff of the Australian Postal Commission. The Australian public would gain most from a move towards a competitive private postal system.

The interests of the management and staff of Australia Post are to resist significant change since they reap economic rents from the present set-up. Australia Post has an enormous advantage in having the ear of the government. Naturally governments will tend to get most of their information about the postal service from the experts, i.e. those who operate it. Australia Post *Annual Reports* project a considerable nervousness about change and contain many appeals and arguments for continuation — and extension — of the Commission's monopoly powers. Nevertheless, as we argue in the next section, it may well be that the management and staff of Australia Post should have an interest in change if they are not to be given monopoly power over electronic mail and other forms of competition.

Another conservative group comprises rural lobbyists, who benefit from significant urban-to-rural cross-subsidisation as part of Australia Post's statutory obligation to have regard to the special needs for postal services of Australians residing and carrying on business outside the cities. The Australian political system has always ceded a disproportionate amount of political power to rural groups and this manifests itself in a number of implicit and explicit rural subsidies. Butlin, Barnard and Pincus (1982:301) note a long history of rural political interest in postal matters: 'During the inter-war period the PMG Department was operated predominantly by Country Party Ministers and by Labor or Liberal Ministers from rural constituencies. Rural subsidies became an enduring part of its activities'. Cross-subsidisation of rural postal users is a very important implicit rural subsidy and rural interests would fight to keep it in the face of any significant threat.

The incidence of the registered publications cross-subsidy is more broadly felt in the community, but the benefits are still concentrated on rural interests. The greatest concession (Category A) mainly comprises postage on country publications and publications directed mainly to country residents, although religious, ex-service and disadvantaged groups also benefit. Country newspaper proprietors receive a greater concession than city ones. Again it is clear that rural interests would be harmed most by adoption of a government policy which, in the process of allowing competition and unshackling the postal service, would result in the removal of the registered publications cross-subsidy. Some resistance may also be expected from the other groups concerned, some of whom (like returned soldiers) have significant political clout.

While rural interests would lose if cross-subsidisation ceased, they would receive an offsetting benefit from reduced overall costs of postal service that would arise after deregulation. This offset would probably not, however, be sufficient to make up for losses. Rural interests are likely to be net losers.

While the most economically efficient outcome would be to completely remove the postal and other subsidies to rural groups, a compromise may be to replace all the present implicit subsidies with some sort of **general** subsidy to people in isolated areas. This would still be inefficient, but it would be more efficient than the present hotchpotch of subsidies on particular items. Other compromises — including the idea of a revenue surcharge — were discussed in Chapter 5.

Strategies for Reform

The real question is **how** can reform be achieved. Our review of the politics of postal monopolies concludes on a rather pessimistic

note. The public at large is not an effective lobby group; special interests are well organised and highly motivated; and Australian governments have failed to grasp reform opportunities in the past. There does not seem to be a substantial potential driving force for reform.

However, monopolies relying on governments for their existence have not always survived, and a number of recent deregulatory moves in Australia and overseas are encouraging. The deregulation of banking and financial markets in Australia and the United States airline deregulation are cases in point. Most commentators seem to regard these radical reforms as major successes. Competitive forces challenging the postal monopoly have not yet been suppressed and this is the basis for considerable optimism.

Pincus (1983:38) discusses the problems that arise because 'merely to advocate efficiency-improving policies is not necessarily to disturb the political-economic equilibrium'. Economists have been offering 'free lunches' (i.e. efficiency gains) since at least the time of Adam Smith and have not found many takers. The special interests have, with only few exceptions, ruled the roost.

One means of reform is to let new forms of competition gradually whittle away the public enterprise's monopoly. As has been noted at a number of points in this study, there are significant rival forces at work in the postal sphere. Electronic mail transmission, the private courier services and the document exchange system are only the three most important. We have also pointed out that in Australia's regulatory history, 'when new products arose in close competition to the existing services offered by the major public enterprises, the monopoly was extended to encompass them' (Pincus, 1983:41). This certainly happened with telecommunications a century ago. One hopeful sign, however, is that allowing new competition to encroach by doing nothing is easier than attempting to remove existing monopoly privileges.

In regard to the United Kingdom postal system, Senior (1983:46) notes that given 'the revolution in information technology, whether the Post Office retains a monopoly of the paper letter will ultimately become irrelevant because it has no rights over the electronic letter ... it must learn to compete **now**'. Senior feels that threats like this give the government system an incentive to want reform. But what Australia Post seems to be seeking is an extension of its paper letter monopoly to cover electronic mail. Only if this objective continues to be resisted will there be a common interest between Australia Post and the public.

The Bradley Committee does not recommend extension of Australia Post's monopoly to electronic mail, although it does suggest that the government keep an eye on this threat to the monopoly. While it thinks the Commission 'should be authorised

to participate in the provision of electronic mail . . . [this] should not be interpreted as including a suggestion that the private sector or other government agencies should be excluded from providing such services' (p.35).

Another strategy is to attempt to reform a number of public enterprises in one fell swoop. Because the per capita gains from deregulating one enterprise such as Australia Post will be quite small (and the outcry from the special interests large), several public monopolies could be reformed along similar lines and the resulting gains would be more perceptible to the public. This might even be accomplished without an equiproportionate increase in the special interest backlash because it removes the 'unfairness' of attacking only one of a number of similar enterprises. The broad-front approach also may not expand the damaged parties in proportion — could rural interests, for example, make twice as much noise if both postal and telephone cross-subsidies were removed than if only one were taken away?

Pincus (1983:39) thinks that it also may be 'prudent to attempt to weaken powerful opposition by judicious compensation'. Efficiency gains might still be possible while compensating the politically relevant interest groups most harmed by demonopolisation. One way to do this is 'vesting', where the enterprise is sold to its management and staff at less than its market value. This may give the operators a vested interest in meaningful reform, although there are ways that it could backfire. Other means of compensation are also possible. For example, cross-subsidisation via postal charges and other means could be replaced by a more efficient general rural subsidy.

All of the above methods of deregulation are simply strategies a government could apply if it wished to secure lower charges, better service, more choice, etc. for the public. Before anything can be done government must want meaningful reform — that is, the government must see a strong public demand for a concerted attack on government-owned monopolies. Unfortunately, Australian governments have not shown a tendency to reform the important public enterprises under their control. The obsession with bureaucratic control rather than market discipline does not augur well for an efficient postal system in the near future.

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