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GOVERNMENT-SPONSORED ENTERPRISES ARE A GLOBAL PROBLEM

Several IRET studies have examined the perils posed to taxpayers, consumers, and private sector businesses by government owned and sponsored enterprises such as the U.S. Postal Service, the TVA, and Amtrak.[1] Government-sponsored enterprises are less sensitive to the needs of their customers and less apt to contain costs and provide efficient service than private businesses, and may demand taxpayer assistance at some point.

> ***[P]roblems arise if government-sponsored enterprises use the revenue generated by government-provided monopoly power or subsidies to expand beyond their core businesses into other activities serviced by private businesses... Concerns posed by such government enterprises are not confined to the United States.***

Additional problems arise if government-sponsored enterprises use the revenue generated by government-provided monopoly power or subsidies to expand beyond their core businesses into other activities serviced by private businesses. Even with a less efficient operation and poorer service, the government enterprises can take market share and damage competing private businesses so long as the enterprises' efforts are bolstered by the deep pockets of their subsidized or protected monopoly divisions.

Concerns posed by such government enterprises are not confined to the United States. Government-owned, sponsored, subsidized, or protected entities are common all around the world. For example, foreign postal services and national telephone companies often are monopoly operations in their core businesses. Efforts by such companies to encroach on other product markets by entering other sectors of the economy or by expanding their traditional services beyond their borders are generally discouraged, for good reason.

In many countries, however, previously monopolized telecom-munications sectors are being opened to foreign and domestic competition. Government shares in these companies are being sold to private investors, and competition from domestic and foreign companies is being introduced. Even some national postal services are being privatized and exposed to competition. Such efforts can be a major boon to consumers and to the economy, particularly where the liberalization of the markets are genuine and complete (with no residual favoritism shown by regulatory officials to the former national enterprises, unlike the case to some degree with the opening of the Mexican phone sector).

As such enterprises are privatized and exposed to competition, they have generally been allowed to expand into other activities, or to extend their geographic reach. Many have expanded across

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national borders to compete with other formerly protected companies on their home ground. For example, the European Union is moving to end national telephone monopolies, and it is likely that the former national companies in Europe will merge or form alliances with each other or with outside investors (such as U.S. telecom firms) to create a few large companies servicing most of the continent. Many European and U.S. telecommunications companies have expanded into Latin America.

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When such developments unfold on a truly competitive playing field, there are enormous efficiencies and benefits to be had. Problems still occur, however, when state owned or supported enterprises retain some government protection or other assistance during or after the decontrol process, or receive preferential treatment from their home country regulators.

[I]n the last few years, several countries have permitted their postal services to move aggressively into competitive markets ... as part of a reform package that would supposedly include selling most or all of the national postal service to the private sector and rolling back or terminating the postal monopoly... Unfortunately, with rare exceptions ... such packages have proven to be one-sided.

For example, in the last few years, several countries have permitted their postal services to move aggressively into competitive markets. This has often been agreed to in other countries as part of a reform package that would supposedly include selling most or all of the national postal service to the private sector and rolling back or terminating the postal monopoly. If fully implemented, the promised privatization reforms would increase competition and get the government out of the letter delivery business. Unfortunately, with rare exceptions (e.g., New Zealand), such packages have proven to be one-sided. Postal authorities have quickly exercised their new powers while privatization has lagged. (True reform is not even on the table in the United States, where the U.S. Postal Service has not endorsed either elimination of its monopoly or its sale to the private sector, but seeks, nevertheless, to participate in competitive markets with few restrictions.)

Some of the pitfalls of the foreign approach to privatization are illustrated by the German experience with its postal service, Deutsche Post World Net. The German reform scenario was to have been that Deutsche Post's domestic letter monopoly would expire at the end of 2002 and that the German government would sell Deutsche Post to the public. In anticipation of privatization, and in exchange for its loss of monopoly status in letter delivery, Deutsche Post received permission from the German government to acquire other firms and enter new markets.

Almost immediately, Deutsche Post went on a buying spree. Since 1997, it has acquired all or part of approximately 60 companies. But while Deutsche Post has aggressively expanded into competitive markets serviced by private businesses, the other parts of the scenario, privatization and de-monopolization of Deutsche Post itself, have faltered. The German government sold 29% of Deutsche Post to the public in 2000. But although the German government is no longer Deutsche Post's sole owner, it remains the majority owner. As for the transition from monopoly to competition, the German government has reneged on its previously announced timetable and postponed competition in the delivery of letters indefinitely. German Economics Minister Werner Mueller now says that Germany should not end its domestic postal monopoly until other European governments do the same and predicts it is "not realistic" to expect such action before 2009.[2] The result is that Deutsche Post will retain for the foreseeable future its monopoly in Germany on the delivery of letters weighing up to 200 grams (approximately 7 ounces).

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The most obvious losers from continued state-mandated monopolization are Germany's postal customers. German postal rates are among the highest in the world and services for customers are limited to what the state-owned monopoly is willing to offer.[3] Opening the market to competition would almost certainly have quickly lowered postage rates while providing customers with a greater range of service choices. There have long been suspicions that Deutsche Post has been charging high prices within its domestic postal monopoly to subsidize other operations, and in March 2001, following an investigation, the European Commission agreed. It fined Deutsche Post 24 million euros for using profits from its monopoly to cross-subsidize its commercial parcel business, and as part of the settlement, Deutsche Post agreed to a partial separation of some of its business operations.[4] Another European Commission investigation is still pending on charges that Deutsche Post has obtained illegal state aid.[5]

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The botched privatization places private-sector companies at an unfair disadvantage. They are barred from competing with Deutsche Post within its monopoly area, and when Deutsche Post enters competitive markets, the businesses in those markets face a state-owned company that receives valuable explicit and implicit government subsidies. Deutsche Post protests that it has financed its acquisitions with billions of dollars of real estate that it was given for free by the German government, rather than from profits from its postal monopoly. But even if that position is accepted, the point is that Deutsche Post is using government aid, in one form or another, as its war chest in its expansion drive.

The problems posed by this partial reform of Deutsche Post are not confined to Germany or Europe. They have spilled over into the United States. Private-sector companies often enter foreign markets in search of attractive opportunities. But if a government-owned company with a monopoly in its home country does so, it may violate the trade laws and restrictions on foreign ownership of the country it is entering. Deutsche Post's acquisition binge is causing just this prob-lem in the United States.

Deutsche Post's continuing ties to its home government may come back to haunt it. Like many countries, the United States has trade rules against foreign companies that use subsidies from their governments to make sales in the U.S. market... [and] has laws restricting foreign ownership in certain industries.

One of Deutsche Post's largest and most controversial acquisitions has been a majority stake in the international air express company DHL International Ltd. It bought 25% of DHL in 1998, took 51% majority control several months ago, and plans to increase its ownership to about 73% within two years. Further, Uwe Dorken, the Deutsche Post executive who designed its logistics expansion strategy, will become DHL's chief executive officer in April 2001.[6] Two other large acquisitions by Deutsche Post are Air Express International Corporation and Swiss-based Danzas Management AG. Deutsche Post's aim, states its chairman, Klaus Zumwinkel, is "to become the number one global player in the logistics industry."[7] Deutsche Post has also expanded beyond mail, parcels, express, and other delivery services into e-commerce and retail banking.

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Deutsche Post's continuing ties to its home government may come back to haunt it. Like many countries, the United States has trade rules against foreign companies that use subsidies from their governments to make sales in the U.S. market. Also like many countries, the United States has laws restricting foreign ownership in certain industries. Now that the majority of DHL is owned by the German postal monopoly, which is primarily owned by the German government, a persuasive case can be made that DHL is owned, controlled, and subsidized by a foreign government. On that basis, several private-sector com-panies and a number of unions have petitioned the Department of Transportation to revoke a license that DHL Worldwide Express, Inc. (100% owned by DHL International) recently obtained to be a forwarder in the United States of foreign air freight. The petitioners assert that it is contrary to U.S. law to open the U.S. interstate delivery market to a foreign owned, controlled[8], and subsidized entity.

One lesson from the Deutsche Post experience is that expansion should not be permitted based on hopes that privatization will follow. To insure that what is marketed as a privatization package does not become a bait-and-switch for expansion alone, privatization should ideally occur prior to expansion. Another lesson is that if a government is reluctant to terminate a postal monopoly, the surest way to prevent cross-subsidization at the expense of postal customers and the owners and employees of private-sector businesses is to require the postal service to stay within its monopoly market. A third lesson is that even if a government-owned postal monopoly tries to expand, its ability to do so outside its home country may be limited by restrictions in other countries on foreign subsidization, control, and ownership.

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The U.S. Postal Service has been seeking to expand into new markets for years. According to the Postal Service, expansion is now especially urgent because after a few years of profits, the agency is again experiencing the red ink that has characterized most of its existence. It claims it could make sufficient profits in other sectors to cover the losses it foresees in its monopoly core business if it fails to control costs and manage itself efficiently in the face of increased competition from e-mail and other services. The true remedy, however, is not a bigger government Postal Service but better control of costs and more efficient management. The revenue side, for example, cannot explain the U.S. Postal Service's loss in fiscal year 2000; although new technologies are enabling some customers to escape the mail monopoly, the Postal Service still had respectable growth rates in revenue and volume of approximately 3% in 2000.[9]

The U.S. Postal Service has been seeking to expand into new markets for years... Far from supporting the U.S. Postal Service's calls for expansion ... the foreign experience warns that expansion without privatization creates additional problems. If the Postal Service retains its mail monopoly and remains part of the federal government, a better policy would be for it to leave competitive markets altogether.

The U.S. Postal Service may point to the removal of restrictions on foreign postal services as an argument in favor of more freedom for itself. Far from supporting the U.S. Postal Service's calls for expansion, however, the foreign experience warns that expansion without privatization creates additional problems.

If the Postal Service retains its mail monopoly and remains part of the federal government, a better policy would be for it to leave competitive markets altogether. It may still have financial difficulties, unless it becomes more successful at controlling its costs. But in all probability expansion, instead of lowering costs, would add extra expenses and generate more dangers for monopoly-market customers, taxpayers, and private-sector businesses.

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Endnotes

1. See Michael Schuyler, "The Postal Service Should Keep Its Hands Off E-Commerce," *IRET Congressional Advisory*, No. 105, May 2000; Michael Schuyler, *The Anti-Competitive Edge: Government Subsidies To Government Businesses*, *IRET Fiscal Issue*, No. 11, September 1999; and Michael Schuyler, *Wrong Delivery: The Postal Service In Competitive Markets* (Washington, DC: Institute For Research On The Economics Of Taxation, 1998).

2. "Germany to Extend Deutsche Post Monopoly Until 2008," Associated Press, March 1, 2001, accessed through Journal of Commerce Online at www.joc.com.

3. When converted into dollars at the current exchange rate, a first-class stamp costs about 50% more in Germany than in the United States: 50¢ compared to 34¢. The cost of first-class postage in Germany had been above 60¢, but it has fallen, when expressed in dollars, because of the sharp drop in the dollar-euro exchange rate.

4. See Philip Shishkin and Rick Brooks, "Deutsche Post Agrees To Split In Two To Avoid Further Antitrust Scrutiny," Wall Street Journal Interactive Edition, March 21, 2001, accessed at www.wsj.com. Also see "Deutsche Post Earnings Meet Hopes, Rising 49% On Strong Earnings Growth," Dow Jones Newswires, March 25, 2001, accessed at www.wsj.com.

5. *Ibid.*

6. "Deutsche Post Architect To Lead DHL," *Lloyd's List*, February 13, 2001.

7. "Deutsche Post Earnings Meet Hopes, Rising 49% On Strong Earnings Growth," Dow Jones Newswires, March 25, 2001, accessed at www.wsj.com.

8. A DHL spokesperson forcefully, but perhaps inadvertently, indicated the line of authority when she referred a reporter's request for a comment to Deutsche Post. See Rick Brooks, "FedEx And UPS Move To Block New Deutsche Post Operations," *Wall Street Journal Europe*, January 24, 2001.

9. *Memo To Mailers*, December 2000, p. 3, accessed at www.usps.com.

Note: Nothing here is to be construed as necessarily reflecting the views of IRET or as an attempt to aid or hinder the passage of any bill before the Congress.