

GOVERNANCE BY MUTUAL BENCHMARKING IN POSTAL MARKETS: HOW STATE-OWNED ENTERPRISES MAY INDUCE PRIVATE COMPETITORS TO OBSERVE POLICY GOALS

*Peter Hettich**

ABSTRACT

The Postal Accountability and Enhancement Act of 2006 is the first comprehensive overhaul of postal service in the U.S. since the establishment of the United States Postal Service ("USPS") in 1971. Compared to developments in other infrastructure sectors, the reforms are timid; the postal monopoly and the USPS as a state-owned enterprise remain untouched. Congress ignored huge reforms in Europe, where the last of the national postal monopolies will fall in 2009 and privatization of some postal providers has occurred.

Although postal service is an important infrastructure sector (an "essential service"), it is clearly not an inherently governmental function. There are many reasons to increase private involvement in postal services, as long as there remains some focus on policy goals like universal service. To maintain universal service, governments in the U.S., the European Community, and Switzerland have imposed a heavy regulatory framework on postal markets. Many governments continue to provide postal services directly through their state-owned enterprises; they charge these enterprises with universal service obligations, the elements of which this essay prescribes in detail. The postal monopoly secures funding for universal service. European governments may derive additional funds for universal service from competitors of the universal service provider; these governments have also extended policy goals like uniform working standards on private postal providers. An economic analysis reveals the inefficiency of the current postal regulatory framework; also, the rationale behind many universal service elements, such as the uniform pricing scheme and a cross-subsidy to sustain rural service, is questionable.

This essay entertains a new concept of public-private competition for postal markets. Governments may use state-owned enterprises to guard policy goals like universal service in postal markets. This allows states to relieve private competitors from regulatory burdens. Summarizing the

* Lecturer for economic constitutional law and regulation at the University St. Gallen (Switzerland); LL.M. (Columbia Law School); Doctor Juris (University St. Gallen); Attorney at Law in Zurich (Switzerland). The author thanks Prof. Dr. Klaus A. Vallender, Prof. Charles F. Sabel, and Prof. Andrzej Rapaczynski for their inputs and support; he expresses his gratitude to the Swiss National Science Foundation, the Janggen-Poehn Foundation, and VISCHER Attorneys at law for their generous financial contributions to his research.

concept, the state-owned enterprise will set a minimum service standard in the market, which serves as a performance benchmark for private competitors. The benchmark pressures private actors to observe policy goals in postal markets if they want to keep up with the service standard available from the state-owned enterprise (threat of replacement). In the same way, state-owned enterprises have to keep up with the performance benchmark of private providers, forcing them to improve efficiency and to resist political meddling. Changes in the current subsidy scheme will make it possible to extend competition from urban to rural areas, where markets are too small to sustain more than one provider; such extension will further improve the mutual benchmarking process. In contrast to other concepts of public-private competition, the benchmarking process described in this paper does not make use of coercive regulation and leaves the competitive process largely intact.

I. INTRODUCTION

General criticism of government services that “too often deliver inadequate service at excessive costs”¹ showed only tiny effects on state-owned enterprises in postal markets. On December 20, 2006, the President signed into law the Postal Accountability and Enhancement Act,² which is the first comprehensive overhaul of postal service since the Postal Reorganization Act of 1970. Compared to reforms in other infrastructure markets, particularly telecommunications, the proposed reforms are rather timid; both the postal monopoly and the status of the USPS as a state-owned enterprise remain unaltered. The new law largely ignores the developments in Europe, where the last postal monopolies will fall in 2009, and where some governments have privatized their state-owned postal providers.

In other regulated sectors, we have been told that private markets are generally the best way to provide goods and services and that the lobbying of special interest groups or the self-interest of politicians motivate most governmental intervention in markets. In general, the true scope of government, according to economists, is probably small under aspects of efficiency. Particularly public law scholars, however, argue that cost savings by privatization,³ if any, are the result of abandoned public policy goals, rather than increased efficiency.⁴ Consequently, they call for

¹ See Executive Office of the President, Office of Management and Budget, *The President's Management Agenda* 3, <http://www.whitehouse.gov/omb/budget/fy2002/mgmt.pdf> (Fiscal Year 2002).

² Postal Accountability and Enhancement Act, Pub. L. No. 109-435, 120 Stat. 3198 (2006).

³ The President expects cost savings of 20-30% by introducing competitive sourcing on a large scale. See Executive Office of the President, *supra* n. 1, at 18; but see Graeme A. Hodge, *Privatization: An International Review of Performance* 97-100 (Westview Press 2000) (reporting average cost savings of 14% after analyzing 135 studies regarding contracting out; adopting a concept of “effect size,” average cost savings amounting to 8-14%; cost savings occurred regardless of the sector to which the contract was awarded).

⁴ See Steven L. Schooner, *Competitive Sourcing Policy: More Sail than Rudder?* 33 Pub. Contract L. J. 263, 265-67 (2004) (arguing that competitive sourcing is used to drop government's headcount, while the remaining civil servants are lacking the abilities of qualified acquisition, contract management, and quality control. In his opinion, expected cost savings are only projected and not guaranteed, and

more scrutiny in privatization decisions and extension of public law norms on private actors by contractual or regulatory provisions (traditional command-and-control regulation).⁵ Still, postal services clearly are not an inherently governmental function, and there are valid reasons to consider private involvement in the provision of postal service.

Traditionally, postal markets have been subject to public policies like universal service, fair and equitable pricing, as well as reliable and efficient service. Like other infrastructure services, governments regard postal services as *merit goods*; simplified, they aim to increase the output of such services. Governments make use of several instruments to achieve these policies—predominantly state-owned enterprises, postal monopolies, and cross-subsidization of prices in rural areas. The redistribution rationale behind these policy goals is dubious. Further, an economic analysis shows that the current combination of instruments is an inefficient way to achieve policy goals in postal markets. However, economic theory does not abrogate decisions of the legislature to increase output in postal markets. Based on the assumption that intervention in postal markets will occur anyway, this article entertains the exclusive use of state-owned enterprises as promoters of policy goals in postal markets. Under the conditions described in this paper, public-private competition triggers a mutual benchmarking process, which allows withdrawal of sector-specific regulatory provisions. The performance benchmark of the state-owned enterprise induces private actors to provide a minimum standard of service; it also pressures them to consider policy goals in their business strategy.

Since a benchmark is not coercive, it leaves the competitive process intact. In contrast to the currently favored instrument of competitive sourcing,⁶ permanent public-private competition continuously secures policy goals, which the competitive process between private actors does not produce. In public-private competition, governmental and private actors are both providing services in markets. Regulators, however, should apply universal service obligations only to the state-owned enterprise and leave private providers committed to market forces. Postal markets, like most infrastructure markets, are large enough to sustain several providers; an

competitive sourcing does not alter the true size of government because contractors simply replace civil servants).

⁵ See Jody Freeman, *Extending Public Law Norms through Privatization*, 116 Harv. L. Rev. 1285, 1314-40 (2003) (accepting the sacrifice of efficiency occurring by the extension of public law norms).

⁶ The Federal Activities Inventory Reform Act (FAIR) forms the legal basis for competitive sourcing. 31 U.S.C. § 501 (1998) (amended 2000). The Act directs federal agencies to issue each year an inventory of all commercial activities performed by federal employees. In addition, the Office of Management and Budget requires agencies to issue an inventory of their inherently governmental activities. See Executive Office of the President, Office of Management and Budget, *Circular No. A-76 (Revised)* Attachment A, http://www.whitehouse.gov/omb/circulars/a076/a76_rev2003.pdf (May 29, 2003) [hereinafter *Circular No. A-76*]. The government performs governmental activities exclusively. Either a competition or a direct conversion process determines the provider of commercial activities. *Id.* at ¶ 4(a)-(c), Attachment A ¶¶ B-C.

additional state-owned player is not able *per se* to undermine competition.⁷ Some economists argue, however, that competition between government and private firms is “disconcerting.”⁸ Thus, possible drawbacks of governmental ownership have to be addressed and the conditions of fruitful public-private competition have to be described.

II. LIMITS IN SHAPING SERVICES OF GENERAL INTEREST

We may expect that the privatization of an essential service provider, e.g. the USPS, would meet strong resistance. Some scholars prefer state-owned enterprises as providers of essential services; they idolize the ethos of public service and argue that only the government is reliable in providing essential services to the poor. In their opinion, administrative hearings, due process, and judicial review are the best guarantors for fairness and accountability. Other scholars favor private enterprises for their inherent incentives to improve quality, to reduce costs and prices, and to foster innovation; they argue that only market forces are maximizing (aggregate) social welfare. As the following subsections will show, public providers of essential services do not perform an inherently governmental function,⁹ nor do they constitute a clear case for privatization.¹⁰ Some essential services may be too complex to maintain the accountability of the privatized entities.¹¹ Regulation of essential services, such as the postal service, attempts to establish a compromise between competition and policy goals. The introduction of competitive elements on a case-by-case basis may, compared to the *status quo*, improve social welfare. These tiny reforms, however, will be regarded as either going too far or as being just a first shy step.

A. Scope of “Services of General Interest”

The overarching term, *services of general interest*, is a quite recent concept. The term does not appear in the U.S. Constitution nor in federal legislation. There is also no reference to the term in the Treaty on European Union or the Treaty establishing the European Community (“EC”) or the secondary legislation. In 2004, however, the European Commission adopted a White Paper declaring “services of general interest as one of the pillars of the European model of society”.¹² The White Paper, and its preceding Green Paper,¹³ does not completely specify the scope of

⁷ In markets where a minimum efficient scale allows only one enterprise in the market (natural monopoly), private sector provision alone hardly renders any benefits for consumers. Privatization of a natural monopoly may necessitate economic regulation.

⁸ See R. Richard Geddes, *Competing with the Government: Anticompetitive Behavior and Public Enterprises* xi, xii (R. Richard Geddes ed., Hoover Instn. Press 2004).

⁹ *Infra* pt. II(B).

¹⁰ *Infra* pt. II(C).

¹¹ *Infra* II(D).

¹² *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: White Paper on Services of General Interest*, COM(04) 374 final at ¶ 2.1 (available at http://eurlex.europa.eu/LexUriServ/site/en/com/2004/com2004_0374en01.pdf) [hereinafter *White Paper*].

¹³ *Green Paper on Services of General Interest*, COM(03) 270 final at ¶ 5 (available at <http://eurlex.europa.eu/>)

these services of general interest. It seems that services of general, economic interest in the EC shall comprise the large network industries such as telecommunications, postal services, electricity, gas and transport, waste management, water supply, and public service broadcasting. Further, the European Commission mentions non-economic services, such as culture, education, health and social services.¹⁴ Switzerland, which is still not a member of the European Union, adopted a report on public services, serving the same purpose as the European Commission's White Paper on services of general interest.¹⁵ The more comprehensive Swiss report covers infrastructure markets like postal services, telecommunication, electronic media, public transport, and roads.¹⁶

These same sectors are also facing regulation in the U.S.¹⁷ The following sections explore the federal government's reasons for intervention in these markets. Any concept for public-private competition will have to implement its concerns.

B. Services of General Interest as Responsibility of the State

In contrast to the U.S. approach of regulation, Europeans discuss the private sector provision of essential services merely as an option, not as a goal. The White Paper of the European Commission largely stresses the responsibility of public authorities, which have to define public service obligations and enact market regulations; pursuant to the paper, the relevant public authorities must retain the powers to ensure that defined public policy objectives are effectively being achieved and that democratic choices are respected.¹⁸ This cautious approach of "controlled liberalisation"¹⁹ emphasizes public policy objectives, rather than higher efficiency or lower costs. Public consultation shows there is opposition to the liberalisation of water supply and the extension of more liberal, sector-specific community regulation to all services.²⁰

Switzerland's report on Services of Infrastructure regards competition as one important instrument to improve efficiency and quality of public services. However, competition shall be introduced only after

LexUriServ/site/en/com/2003/com2003_0270en01.pdf) [hereinafter *Green Paper*].

¹⁴ *Id.* at ¶ 31-33, 45-47 (stressing that the distinction between economic and non-economic has been dynamic and evolving, and for an increasing number of services, this distinction has become blurred; the Commission mentions services without effects on trade of member states, as well).

¹⁵ The Federal Authorities of the Swiss Confederation, *Bericht des Bundesrates: Grundversorgung in der Infrastruktur* [Report of the Federal Government: Basic Supply in the Infrastructure] 4569-4644, <http://www.admin.ch/ch/d/ff/2004/4569.pdf> (Jun. 23, 2004) [hereinafter *Basic Supply in the Infrastructure*].

¹⁶ *Id.* at 4572-73 (schools, health care, prisons, etc. are not mentioned by the report since they are not covered by the competencies of the federation).

¹⁷ The telecommunication markets know, e.g., regulation regarding service and charges, 47 U.S.C. § 201 (1934), and universal service, 47 U.S.C. § 254 (1934) (amended 2002).

¹⁸ See *White Paper*, *supra* n. 12, at ¶ 2.2.

¹⁹ See *Green Paper*, *supra* n. 13, at ¶ 5.

²⁰ See e.g. European Parliament, *European Parliament Resolution on the Green Paper on Services of General Interest*, COM(03) 270 (available at <http://www.eurofedop.org/docs/documents/highlight.EN-WEB.pdf>).

sector-specific case-by-case assessments; such assessments shall also determine the ownership of enterprises providing public services (state-owned, shared public-private, or private).²¹ Both the Swiss government and its citizens seem to be increasingly apprehensive of further privatization. For example, recent public votes showed a majority against the restructuring of a major electricity supplier and against the liberalisation of the Swiss electricity market.²² It seems the battle for full privatization and liberalisation of infrastructure markets in Europe is lost. According to the European Commission:

[S]ome services of general interest are not fully satisfied by markets alone because their market price is too high for consumers with low purchasing power or because of the cost of providing these services could not be covered by market price. Therefore, it has always been the core responsibility of public authorities to ensure that such basic collective and qualitative needs are satisfied and that services of general interest are preserved wherever market forces cannot achieve this. To date, the crucial importance of this responsibility has not changed.²³

Although there is no generally accepted concept of *inherently governmental functions*, most scholars probably would agree that essential services form no part of such functions. In 1991, GAO Report 92-11 held that “the concept of governmental functions” is difficult to define and is, therefore, subject to varying interpretations.²⁴ GAO argued that governments should not contract out functions like presenting testimonies, holding hearings, representing an agency before the public, and supervising federal employees; however, the report found that governments sometimes enter into service contracts that appear to involve governmental functions.²⁵ The FAIR Act provides a definition of *inherently governmental functions* in a very rudimentary form.²⁶ Activities, which do not relate intimately to

²¹ See *Basic Supply in the Infrastructure*, *supra* n. 15, at 4572.

²² Public vote held on June 10, 2001 (Cantonal law of February 26, 2001 on the reorganization of electricity supply), *Beschluss des Kantonsrates über die Erhaltung der Ergebnisse der kantonalen Volksabstimmung vom 10. Juni 2001*, 35 Official Gazette of the Canton of Zurich (Aug. 31, 2004) (available at <http://www.amtsblatt.zh.ch/>), and public vote held on September 22, 2002 (Federal law of December 15, 2000 on the electricity market), The Federal Authorities of the Swiss Confederation, *Bundesratsbeschluss über das Ergebnis der Volksabstimmung vom 22. September 2002 [Resolution of the Federal Government over the Result of the Popular Vote from September 22, 2002]*, <http://www.admin.ch/ch/d/ff/2002/7821.pdf> (Nov. 26, 2002).

²³ *Green Paper*, *supra* n. 13, at ¶ 22.

²⁴ See *Government Contractors: Are Service Contractors Performing Inherently Governmental Functions?* Rpt. to the Chairman, Fed. Serv., Post Off. and Civ. Serv. Subcomm., Comm. on Govtl. Affairs, U.S. Sen., 5, 18-19, 37-45, (GAO Nov. 1991) (available at <http://archive.gao.gov/t2pbat7/145453.pdf>) [hereinafter *Government Contractors*] (affirming that the executive branch has generally assumed responsibility for defining governmental functions).

²⁵ *Id.*

²⁶ See *FAIR Act*, 31 U.S.C. § 501(5)(2)(a); see also *Circular No. A-76*, *supra* n. 6, at Attachment A ¶ B(1) (inherently governmental functions are activities that require either the exercise of discretion or the making of value judgments. This includes the interpretation and execution of the laws so as to bind the U.S. to take some action; to advance U.S. interests by military or diplomatic action, judicial

public interest, such as commercial activities, are subject to privatization or contracting out. This includes services provided by public utilities.²⁷ Unfortunately, the debate on *inherently governmental functions* is driven more by constitutional issues than by economic arguments.²⁸ The vague limits of governmental activities give governments a lot of discretion in defining their realms.

Government services may be public goods, in which case privatization would fail because of the lack of a private market. Economists acknowledge that markets may fail in case of externalities, public goods, monopolies, and asymmetric information.²⁹ Market failures may be severe enough that regulatory intervention may increase social welfare. Even if markets do not fail, the use of regulatory instruments is tempting for the implementation of public goals, since the costs of these instruments for the government are low and they are easy to enact. While such regulation may increase the welfare of some individuals, it distorts markets and is generally not suited to increase social welfare (understood as aggregate individual welfare). In its White Paper, however, the European Commission admits implicitly that the traditional market-failure justification does not apply to infrastructure markets; the Commission's reasons for intervention are *merit good* considerations.³⁰ It is a highly disputed question whether there are collective wants besides individual wants, and whether the government should provide these collective wants even if they are beyond the classic economists' concept of public goods.

The market could provide these collectively desired goods (merit wants), but they are considered so meritorious that their satisfaction must be provided for through the public budget over and above any market

proceedings, contract management; to significantly affect the life, liberty, or property of private persons; to appoint or control officers or employees of the United States; or to exert ultimate control over property of the U.S.).

²⁷ See *infra* n. 67 and accompanying text.

²⁸ In *Marsh v. Alabama*, 326 U.S. 501 (1946), the court decided that a state, consistently with the First and Fourteenth Amendments, cannot impose criminal punishment on a person who undertakes to distribute religious literature on the premises of a company-owned town contrary to the wishes of the town's management. Therefore, the court held the company town to be a state actor, but did not question the constitutionality of such towns. *Id.* The existence of company-owned towns shows there are hardly any functions the government has to provide directly. *Id.* Only privatized prisons may be better suited to demonstrate this. See also *Evans v. Newton*, 382 U.S. 296 (1966) (holding unconstitutional a tract of land willed in trust as a park for white people and operating for years as a public facility because it operated as a segregated park).

²⁹ See e.g. Michael J. Trebilcock & Edward M. Iacobucci, *Privatization and Accountability*, 116 Harv. L. Rev. 1422, 1430-36 (2003); Lester M. Salamon, *Economic Regulation*, in *The Tools of Government* 117, 138-45 (Lester M. Salamon ed., Oxford U. Press 2002).

³⁰ The European Commission is probably right not to justify its intervention in markets for services of general interest with market failures. Taking into account the realm of services of general interest mentioned by the European Commission and the Swiss Government, it is obvious that these services are common private goods and are all provided to a large extent by the market. Public goods, defined by non-rivalry and non-exclusivity of consumption, would clearly not be satisfied by the market in the amount now observable in infrastructure markets. Even if some of the mentioned essential services were public goods, the government would not necessarily have to provide the service itself, but could make use of contractors.

provision that individuals may wish to make.³¹ Musgrave explains this defiance of consumer sovereignty by the emergence of certain situations, in the context of a democratic community, where an informed group considers itself being justified in imposing its decisions upon others.³² Based on the same string of argument, the concept of merit wants may be derived by weakening the assumption of market knowledge and rational behavior.

In contrast to Musgrave's view of merit wants as authoritarian-imposed consumption, the existence of group needs (public wants differing from private wants) could justify the provision of merit goods by the government from an economic perspective.³³ Economists, however, have noted that there is no need for the concept of merit goods at all. They object, claiming the concept of merit goods serves as a circular argument for government intervention. To identify merit goods it is sufficient that the government is intervening in markets, which are not affected by market failures.³⁴

I yield to the fact that, to my knowledge, no constitution of a western democracy prevents collective decisions favoring governmental undertakings,³⁵ and I will not dare to conclude the dispute on collective undertakings. Since the *Lochner*³⁶ Era, the Supreme Court has refused to invalidate laws which are thought unreasonable, that is, unwise or incompatible with some particular economic or social philosophy.³⁷ Today, the scope of economic freedom in any given market is determined through the political process.³⁸ If efficient market organization was the only goal in services of general interest, there would be no reason for regulation or state-owned enterprises. The task of a (benevolent) government concerned with social welfare would simply be to privatize and deregulate these markets.

³¹ See Jack Wiseman, *The Public Economy*, 27 *Economica* 258, 261 (1960). In this context, privatization is often found to undermine social welfare, since privatization shifts the focus to individual wants. According to this view, private markets produce merit goods in such a small amount that they are not available for the poor. Indeed, private companies have little interest to benefit persons other than shareholders. However, the level of social welfare does not depend on the choice between public and private service provision. There is no such thing as, e.g., a *free* school, and privatization simply transforms the share of taxes spent for schools in tuition, i.e. privatization alters the way of financing. While a public school can accept anyone since social welfare and schools are paid by the same purse, a private for-profit school will accept impecunious students only if it gets reimbursed. This decision on the level of social welfare is a collective one; the government is hiding its true motivation if it undertakes privatization to undermine this collective decision. Privatization forces the government to reveal the costs of the collective decision. Cf. Greg Palast et al., *Democracy and Regulation: How the Public Can Govern Essential Services* 36, 67-68, 73-79 (Pluto Press 2003); see generally Milton Friedman, *Capitalism and Freedom* 190-195 (U. of Chi. Press 1982).

³² See Richard A. Musgrave, *The Theory of Public Finance* 14 (McGraw-Hill 1959).

³³ See e.g. Wiseman, *supra* n. 31, at 266.

³⁴ See Agnar Sandmo, *Ex Post Welfare Economics and the Theory of Merit Goods*, 50 *Economica* 19, 21 (1983); James M. Buchanan, *The Theory of Public Finance*, 26 *S. Econ. J.* 234, 237 (1960).

³⁵ See *infra* nn. 178-179 and accompanying text.

³⁶ *Lochner v. N.Y.*, 198 U.S. 45 (1905).

³⁷ *Nebbia v. N.Y.*, 291 U.S. 502, 536-37 (1934) ("[s]o far as the requirement of due process is concerned, and in the absence of other constitutional restriction, a state is free to adopt whatever economic policy may reasonably be deemed to promote public welfare, and to enforce that policy by legislation adapted to its purpose"); See also *Coast Hotel v. Parrish*, 300 U.S. 379, 399 (1937).

³⁸ *U.S. v. Carolene Products Co.*, 304 U.S. 144, 152 n. 4 (1938); *Williamson v. Lee Optical Co.*, 348 U.S. 483, 487-88 (1955).

If legislators identify public goals to pursue beyond market efficiency, however, they will interfere in markets.

In the market for postal services, governments traditionally have assumed a strong role. It seems futile to ask whether intervention shall occur at all; it is probably more promising to design a regulatory framework, which implements policy goals without completely losing focus on efficiency. In postal service, it is not known to what extent private actors would satisfy policy goals voluntarily, without being forced by regulatory safeguards. With today's amount of regulation in postal service, it will never be known whether technological innovation or new organizational methods have superseded the need for market intervention. Today's regulatory framework does not allow competition to show its positive effects, such as the introduction of new business models, which would allow sustainable postal service even in rural areas.

C. Reasons for Privatization of Services of General Interest

This article uses the term *privatization* to identify any governmental measure, which shifts the responsibility for the provision of services in whole or in part to private actors, regardless of the method of funding such services.³⁹ While these measures in the U.S.⁴⁰ consist largely of contracting out, the partial sell-off of publicly owned companies and the enactment of regulatory safeguards seems predominant in the European Union and Switzerland.

If markets fail (the economists' only justification for government intervention), governments may provide the service directly or contract with a private actor to provide the service; thus, market failures do not necessarily require governmental enterprise. Consequently, there is hardly any service where private provisions are—in an economist's view—unthinkable. There may still be economic reasons against privatization, such as contractual problems like high transaction costs, intransparency, or threat of renegotiation with incomplete contracts.⁴¹

Economists hardly deal with the social, philosophical, constitutional, or other non-economic limits of privatization; there is no

³⁹ Privatization may occur in several ways. It is not surprising that the term is used for a wide array of different forms of modifying public ownership such as: complete or partial sell-off of public enterprises, deregulation of an industry, commercialization of a government department, removal of subsidies, and contracting with or financing private providers to perform formerly governmental services. Privatization usually means establishing private ownership, but the boundary between public and private actors becomes sometimes blurred by heavily regulatory constraints. See e.g. Hodge, *supra* n. 3, at 13-14; Freeman, *supra* n. 5, at 1287; Ellen Dannin, *To Market, to Market: Legislating on Privatization and Subcontracting*, 60 Md. L. Rev. 249, 258-59 (2001).

⁴⁰ See *Privatization: Lessons Learned by State and Local Governments*, Rpt. to the Chairman, H. Republican Task Force on Privatization, 1 (GAO Mar. 1997) (available at <http://www.gao.gov/archive/1997/gg97048.pdf>) [hereinafter *Privatization*].

⁴¹ See Oliver Hart et al., *The Proper Scope of Government: Theory and an Application to Prisons*, 112 Q. J. of Econ. 1127, 1155-59 (1997) (on foreign policy, police and armed forces); Oliver E. Williamson, *Public and Private Bureaucracies: A Transaction Cost Economics Perspective*, 15 J.L., Econ., & Org. 306, 331-36 (1999).

mathematical theory whether public institutions are necessary to hold a society together.⁴² People recognize the monopoly over the legitimate use of force and the judiciary as a fundamental institution of the state, but also recognize educational services, electricity, roads, and prisons. The respective facilities are regulated heavily, if not owned, by the public. Public law scholars fear that privatization of such facilities destroys the link between the state and its people.⁴³ However, private schools, private security, private courts, etc. have established themselves in many western countries. In developing countries, private institutions may be the only way to access the necessary funds to provide an essential service at all. With a growing private sector in essential services, however, the significance of the government diminishes. In the eyes of future generations, a government that only manages service contracts may fail to legitimize its existence. In the same way, a government may fail to demonstrate its legitimacy if it provides services in an inefficient or wasteful manner. Efficiently organized essential services may fail to achieve goals of justice, fairness, and equitable distribution; still, it seems hardly possible for inefficient, wasteful services to achieve these goals.⁴⁴ *Ceteris paribus*, the choice between inefficient government services and efficient privatized services seems easy.

Public choice theorists argue that state-owned enterprises and regulation are mainly instruments to assign rents to supporters of politicians or other interest groups, and that only full privatization will prevent politicians from wasting tax dollars on self-serving—but unnecessary—government programs.⁴⁵ They argue that market mechanisms will produce a *pareto* optimal result, will lead to output at the socially desired level, and will determine a price clearing the market. Market mechanisms provide incentives for constant innovation and improvement, since competitors will eventually erode advantages of superior production. A competitive environment is more capable of experimentation and institutional innovation, while governments may refuse testing new techniques in the market. Privatization is an instrument to reduce the public sector share of

⁴² Cf. Martha Minow, *Public and Private Partnerships: Accounting for the New Religion*, 116 Harv. L. Rev. 1229, 1253-55 (2003); Dannin, *supra* n. 39, at 263-64 (both stressing the importance of some government services for national identity); Mark H. Moore, *Introduction to Symposium: Public Values in an Era of Privatization*, 116 Harv. L. Rev. 1212, 1218 (2003).

⁴³ Such deterioration may occur if the state abandons the responsibility for the direct provision of security, schooling, or social welfare, even if the state maintains its role in funding these services. See e.g. Lester M. Salamon, *The Governance and the Tools of Public Action: An Introduction*, in *The Tools of Government*, *supra* n. 29, at 38; Ruth Hoogland DeHoog & Lester M. Salamon, *Purchase-of-Service Contracting*, in *The Tools of Government*, *supra* n. 29, at 330-31 (arguing that role ambiguities may be a reason to refrain from contracting out corrections, group homes for mentally ill, juvenile detention and child protective services).

⁴⁴ Cf. Hans-Bernd Schäfer & Claus Ott, *Lehrbuch der ökonomischen Analyse des Zivilrechts* [*Economic Analysis of Civil Law*] 6 (3rd ed. Edward Elgar 2000); Peter Hettich, *Wirksamer Wettbewerb: Theoretisches Konzept und Praxis* [*Effective Competition: Theoretic Concept and Case Law*] 335 (Haupt Verlag 2003).

⁴⁵ See generally Andrei Shleifer & Robert W. Vishny, *The Grabbing Hand: Government Pathologies and Their Cures* 137-81 (Harvard U. Press 1998); Hodge, *supra* n. 3, at 36-38.

the economy, increasing the room for private initiative.⁴⁶ High transaction costs (e.g. for negotiation and oversight) and transformation costs may exceed aggregate cost savings in privatization, resulting in a net welfare loss for the society. However, the ability of private markets to adapt to future developments as well as the value of private initiatives, free personal decisions, voluntary interactions, and consumer choice may induce governments to make the investment in privatization anyway.⁴⁷

Privatization proponents tend to highlight the differences of structure and organization as well as the institutional qualities of the private sector, promising efficient and high quality services, as well as continuous adaptation to a changing environment. Hierarchical forms of organizations, like agencies, are deemed less capable of obtaining these qualities.⁴⁸ The civil service, however, may have other inherent qualities. For example, its employees may focus more on the implementation of public goals, and a public agency may be the best governance structure reply to the hazards of probity.⁴⁹ The property rights theory of the firm concludes that the residual claimant of state-owned enterprises (the government) has less incentive to monitor managers, which will ultimately impair performance. One reason for this failure may be that residual cash flow claims of state-owned enterprises are more difficult to transfer compared to shares of private companies. The management of state-owned enterprises assigns assets that are more likely to be used inefficiently. The management will also engage in non-pecuniary forms of opportunism, such as excess consumption (e.g. trying to exhaust budgets at the end of the budget cycle) or slacking on the job.⁵⁰

Regulatory provisions, enacted to protect civil servants, often

⁴⁶ However, to contract out to a private actor doing 100% of its business with the government hardly reduces the size of the government; some scholars even argue that the huge contractors' workforce may even hide a growing government. Such artificial markets seem very vulnerable to problems related with monopoly and/or monopsony power, and not at all immune against public and political pressures. Only if the provision and the funding of the service is privatized (purchase decisions made by private actors), the size of the government is reduced. See John A. O'Looney, *Outsourcing State and Local Government Services: Decision-Making Strategies and Management Methods* 24 (Quorum Books 1998); John J. DiIulio, Jr., *Response Government by Proxy: A Faithful Overview*, 116 Harv. L. Rev. 1271, 1273 (2003); Moore, *supra* n. 42, at 1214.

⁴⁷ Cf. Klaus A. Vallender et al., *Wirtschaftsfreiheit und begrenzte Staatsverantwortung [Economic Freedom and Limited Responsibility of the State]* 188-89 (Stämpfli Verlag 2006).

⁴⁸ See e.g. Trebilcock & Iacobucci, *supra* n. 29, at 1424-30. That may be the reason why we still refer to Max Weber to characterize bureaucracies, which would be unthinkable in cases of private firms. See Max Weber, *Economy and Society* 956-959 (Guenther Roth & Claus Wittich eds., U. of Cal. Press 1978); see also Christopher K. Leman, *Direct Government*, in *The Tools of Government*, *supra* n. 29, at 55-61.

⁴⁹ See Williamson, *supra* n. 41, at 328-30, 338 (arguing that probity is a vague concept).

⁵⁰ See Jerry Mitchell, *The American Experiment with Government Corporations* 112-24 (M.E. Sharpe, Inc. 1998); James Q. Wilson, *Bureaucracy* 317-31 (Basic Books 1989); Anthony E. Boardman & Aiden R. Vining, *Ownership and Performance in Competitive Environments: A Comparison of the Performance of Private, Mixed, and State-Owned Enterprises*, 32 J.L. & Econ. 1, 1 (Apr. 1989); Hart et al., *supra* n. 41, at 1129 (arguing that the government employee receives only a fraction of either the returns of quality improvement or cost reduction, since the government retains residual control rights over the asset. In contrast, a private contractor need no government approval for cost reduction, but has to negotiate for a higher price in case of quality improvement; therefore, the incentive for cost reduction is stronger than for quality improvement); Trebilcock & Iacobucci, *supra* n. 29, at 1426.

prevent executives from rewarding or punishing employee performance, which reduces the respective incentives for employees. Private contractors may also recruit their workforce from different sources, thereby providing additional expertise lacking in civil service. The private sector may attract staff not available to the public sector because of more attractive or more flexible working conditions or because of the private sector's ability to award excellence. There may be highly qualified workers, however, who prefer predictable working conditions and more job security. There is also the argument that privatization saves costs mainly at the expense of the workforce's wages, leading to a frequent turnover and to a loss in expertise. Some U.S. states are trying to impose public working standards on privatized enterprises, for example, by preventing contractors from terminating contracts with current workers.⁵¹ In this context, it may also be argued that privatization forces governments to maintain some in-house expertise to provide services in cases of emergencies, to reduce the vulnerability of the population being served, to diffuse political power connected to these services, or to preserve exit options such as the option to step back in.

Although economic theory predicts a higher probability for waste in state-owned enterprises, consumers may be satisfied with the services provided by the government. The provided output level and the price and availability of services is the result of central planning embodied in regulation. Ex-ante-planning will never be able to anticipate market outcome, leading to oversupply or undersupply of the provided good. Frequently, state-owned enterprises enjoy special privileges, which reduce their incentives to enhance efficiency and cut costs; this may lead to waste, cuts in innovation, or oversupply.⁵² Therefore, satisfaction of the public with governmental services may also imply that the state-owned enterprise produces too much of a specific good or sells the good at too low of a price. Citizens are generally not aware of the hidden costs of government services, which lie in taxes, tariffs, and distortions in related markets.⁵³

D. Struggle to Maintain Accountability of Privatized Service Providers

The growing private involvement in government concerns

⁵¹ See e.g. Mass. Gen. Laws ch. 7, §§ 52-55 (2007); cf. Dan Guttman, *Governance by Contract: Constitutional Visions; Time for Reflection and Choice*, 33 Pub. Contract L. J. 321, 350-51 (2004); Dannin, *supra* n. 39, at 283-86.

⁵² Traditional privileges of public enterprises include, e.g. monopoly power, credit guarantees, captive equity, exemption from bankruptcy and taxes, direct subsidies, regulatory exemptions (from applying for building permits, vehicle registration, etc.), and the power of eminent domain. See R. Richard Geddes, *Case Studies of Anticompetitive SOE Behavior*, in *Competing with the Government*, *supra* n. 8, at 27, 28-34; Michael A. Froomkin, *Reinventing the Government Corporation*, 1995 U. Ill. L. Rev. 543, 583-84 (1995).

⁵³ Oversupply, excessive standby-capacity, standards of reliability and uninterruptibility are likely results of incompletely exploited monopoly power and a rate of return in excess of marginal costs of capital, both of which regulation is likely to entail; although not efficient, such investments may serve to expand a given rate base or to justify rate increases. See Alfred E. Kahn, *The Economics of Regulation: Principles and Institutions* vol. 2, 49-59 (MIT Press 1988); cf. Hart et al., *supra* n. 41, at 1146 (arguing that excessive employment in public enterprises may lead to excessively high quality).

administrative law scholars for its asserted implications on *democratic norms*, such as lack of accountability, due process, equality, and rationality. In their view, lack of accountability is a lack of political accountability, i.e. lack of personal responsibility of magistrates in office, lack of parliamentary control, and lack of judicial review.⁵⁴ Some scholars take the opposite view and argue that privatization increases accountability by forcing officials to reveal the costs, performance goals, and measurement criteria of a specific service.⁵⁵ In any case, the traditional accountability mechanisms, such as removal of officers, hearings, due process, and judicial review, are inadequate to constrain discretion of decentralized, private entities. Private actors are, in contrast to agencies, not subject to direct oversight from the executive or legislative body or to judicial review; they are even more distant from the electorate than agencies.

Privatization may even serve to avoid certain administrative and constitutional requirements in the provision of services, resulting in a lower level of individual protection from arbitrary decisions. However, the capabilities of governmental agencies to maintain the desired level of protection at all times are also limited. Moreover, we do not miss the lack of judicial review in essential services traditionally provided by private actors. For instance, a grocer selling contaminated food is subject to liability in civil and criminal law. On the other hand, where waterworks provide drinking water, such liability might be regarded as insufficient. Studies show that most municipalities expect to save money with privatization, while only few seek a higher quality of services.⁵⁶ The reluctance to privatize waterworks is easily explained as long as privatization means choosing only the cheapest but unqualified provider.⁵⁷ Some sectors may be delicate enough to make it worth paying the price for administrative hearings, judicial review, and procedures like notice-and-comment rulemaking.⁵⁸ Indeed, some scholars fear that unscrupulous, profit-maximizing enterprises could extort or hold the public hostage by refusing to provide *essential services* when the population needs these services most.⁵⁹

Private service providers and contractors, whether working for

⁵⁴ See Alexander Hamilton, *The Federalist No. 70* in *The Federalist* 461 (Great Minds Series, Prometheus Books 2000); Chris Reeder, *Regulation by Contractors: Delegation of Legislative Power to Private Entities in Texas*, 5 Tex. Tech. J. Tex. Admin. L. 191, 193-94 (2004); Hodge, *supra* n. 3, at 146 (giving an overview on different concepts of accountability).

⁵⁵ See John A. Rehfuss, *Contracting Out in Government: A Guide to Working with Outside Contractors to Supply Public Services* 53-54 (Jossey-Bass Publishers 1989).

⁵⁶ See Darrell A. Fruth, *Economic and Constitutional Constraints on the Privatization of Government Information Technology Services*, 13 Harv. J.L. & Tech. 521, 524 (2000).

⁵⁷ See Dannin, *supra* n. 39, at 273-77, 314 (arguing that the preservation of public health may be an obstacle to privatization; states should be already well prepared to deal with extortion, bribery, misfeasance and breach of contract).

⁵⁸ Of course, notions diverge which sectors are so critical that performance cannot easily be left to chance. If "key infrastructure functions" like postal services, justifies direct government, as noted by Christopher K. Leman, *Direct Government*, in *The Tools of Government*, *supra* n. 29, at 61-62, then we may ask why telecommunications are left to private actors.

⁵⁹ See Dannin, *supra* n. 39, at 273.

profit or non-profit, are following their own agenda;⁶⁰ it would be pure coincidence if such undertakers would have the same goals as the government, which provided the services before. If the task is to review social welfare claims, contracting out to the Salvation Army or to the National Taxpayers Union will show different effects. Both non-profit organizations will fill contractual or regulatory loopholes in their own way, in accordance with their mission. They may even try to circumvent some bothering obligations. Shifting the provision of services from the government to the private sector will lead to a change in the way these services are provided. Such shifting is unavoidable and commonly known as the principal-agent problem.⁶¹

Public law scholars, fearing that governments may lose grip on education, fire departments, police, or tax collection after privatization, want to implement constitutional guarantees, thereby turning the privatized entities into state actors.⁶² Although the courts sometimes have imposed constitutional constraints and oversight requirements on private actors, there is a reluctance to make this a general rule. Applying a two-tiered test to identify private actors as state actors, the court in *Lugar v. Edmondson Oil Co.* first asked whether the claimed constitutional deprivation resulted from the exercise of a right or privilege having its source in state authority, and second, whether the private party charged with the deprivation could be described in all fairness as a state actor.⁶³ Affirming the *Lugar*-test, the court in *Edmonson v. Leesville Concrete Co.* found that a particular action is governmental in character if: 1) the actor relies on governmental assistance and benefits to a certain extent, 2) the actor is performing a traditional governmental function, or 3) the injury caused is aggravated in a unique way by the incidents of governmental authority.⁶⁴

In *Nixon v. Condon*⁶⁵ and *Terry v. Adams*,⁶⁶ the U.S. Supreme Court held that political parties, although private associations, are bound by the Fourteenth Amendment while holding their primary elections. Being outside this core of governmental functions, the Supreme Court refused to assess electricity services as fulfillment of public functions in *Jackson v. Metropolitan Edison Co.*⁶⁷ Instead, the *Jackson* Court held that only

⁶⁰ See Michael Taggart, *The Province of Administrative Law Determined?* in *The Province of Administrative Law* 1, 4-5 (Michael Taggart ed., Hart Publg 1997).

⁶¹ Not to mention problems which are even more complex like the coordination of actors in networks. See generally Lester M. Salamon, *The Governance and the Tools of Public Action: An Introduction*, in *The Tools of Government*, *supra* n. 29, at, at 12-14.

⁶² See also Daphne Barak-Erez, *A State Action Doctrine for an Age of Privatization*, 45 Syracuse L. R. 1169, 1170 (1995).

⁶³ 457 U.S. 922, 939-42 (1982).

⁶⁴ 500 U.S. 614, 621 (1991); see also *Tulsa Prof. Collection Servs., Inc. v. Pope*, 485 U.S. 478 (1988); *Terry v. Adams*, 345 U.S. 461 (1953); *S.F. Arts & Athletics, Inc. v. U.S. Olympic Comm.*, 483 U.S. 522 (1987); *Shelley v. Kraemer*, 334 U.S. 1 (1948).

⁶⁵ 286 U.S. 73 (1932).

⁶⁶ 345 U.S. 461.

⁶⁷ 419 U.S. 345, 353 (1974); see also *West v. Atkins*, 487 U.S. 42, 54 (1988) (finding delivery of medical treatment to state prisoner by physician employed under contract by state to be state action); *Edmonson*, 500 U.S. at 620 (citing *Lugar*, 457 U.S. at 941-42).

services traditionally associated with sovereignty are subject to the state action doctrine.⁶⁸ Citing *Nebbia v. New York*,⁶⁹ the *Jackson* Court held that the fact certain businesses are "affected with a public interest" can, in the nature of things, mean no more than that an industry, for adequate reason, is subject to control for the public good."⁷⁰ The *Jackson* Court also expressly rejected that extensive state regulation or enjoyment of a partial monopoly could turn, absent more, private actors into state actors.⁷¹ In *Flagg Bros., Inc. v. Brooks*, the Court reasoned, "the crux of respondents claim is not that the state has acted, but it has refused to act," a situation typical for privatized markets.⁷² In *Lebron v. National Railroad Passengers Corp.*, the Court denied Amtrak, whose assets were then wholly owned by the government, to be a private actor performing state functions; the Court found Amtrak to be part of the Government itself.⁷³ However, the Court will not necessarily find a state-owned enterprise to be a state actor.⁷⁴ The status of public enterprises is even more difficult to determine in mixed-ownership cases or private enterprises with presidential appointed directors.⁷⁵ Thus, most attempts to get the courts to apply the state action doctrine on privatized companies providing *essential services* did fail, leaving the public without the traditional protective barriers provided by

⁶⁸ With regard to other "public" utilities, see also *Rendell-Baker v. Kohn*, 457 U.S. 830, 842 (1982) (holding that the operation of schools for "problem" children referred by public institutions is not a state action); *Blum v. Yaretsky*, 457 U.S. 991, 1011-12 (1982) (no state action by operation of nursing homes the patients of which are practically all funded by public resources).

⁶⁹ 291 U.S. 502.

⁷⁰ 419 U.S. at 353.

⁷¹ *Id.* at 351-352; see also *Public Utilities Commn. v. Pollak*, 343 U.S. 451, 462 (1952) (holding that broadcasting radio program in public buses does not violate the First nor the Fifth Amendment); *Moose Lodge No. 107 v. Irvis*, 407 U.S. 163, 171-79 (1972) (affirming that the Court has never held that discrimination by an otherwise private entity would violate the Equal Protection Clause if the private entity receives any sort of benefit or service at all from the state, or if it is subject to state regulation in any degree whatsoever); but see *Burton v. Wilmington Parking Auth.*, 365 U.S. 715, 723 (1961) (finding the lessee of a restaurant operated on public ground subject to the requirements of equal protection by the Fourteenth Amendment).

⁷² 436 U.S. 149, 166 (1978) (respondents argue that the sale of belongings by a private warehouseman violates their right of due process).

⁷³ 513 U.S. 374, 394-400 (1995) (reasoning that Amtrak was created by special law, for the furtherance of governmental objectives, and the government retains for itself permanent authority to appoint a majority of the directors of that corporation); see also *U.S. Grain Corp. v. Phillips*, 261 U.S. 106, 113 (1923) (holding that Grain Corp., although in the form of a private corporation, is an agency for public service and clothed with such a public interest); *U.S. v. Walter*, 263 U.S. 15, 17-18 (1923) (holding that fraud against the Shipping Corp. is punishable as conspiracy to defraud the U.S.); *Emerg. Fleet Corp. v. W. Union Telegraph Co.*, 275 U.S. 415, 426 (1928) (holding that the Fleet Corp. is entitled to government rates for telegrams because it is a department of the U.S. within the meaning of the Post Roads Act); *Inland Waterways Corp. v. Young*, 309 U.S. 517, 523 (1940) (holding that a bank may give security to a wholly owned public enterprise despite its separate legal personality); *Cherry Cotton Mills v. U.S.*, 327 U.S. 536, 539 (1946) (holding that the debts of the Reconstruction Finance Corp. is a debt of the U.S., since it accomplishes purely governmental purposes).

⁷⁴ *U.S. v. Strang*, 254 U.S. 491, 493 (1921) (holding that Fleet Corp. was not an agent of the Government within the meaning of the federal criminal code prohibition of conflicts of interest); *Sloan Shipyards Corp. v. U.S. Shipping Bd. Emerg. Fleet Corp.*, 258 U.S. 549, 569-70 (1922) (holding that claims against Fleet Corp. should be heard in a state court or federal district court rather than the Court of Claims, and that Fleet Corp.'s claims are not privileged in bankruptcy); *U.S. ex rel. Skinner & Eddy Corp. v. McCarl*, 275 U.S. 1, 11 (1927) (holding that Fleet Corp. is an entity distinct from the U.S. and not subject to federal audit and control).

⁷⁵ See Froomkin, *supra* n. 52, at 572-74.

administrative law.⁷⁶ Even a broader application of the state action doctrine might not help, because courts may turn out to be too slow, cumbersome, and costly to provide effective relief. The competitive process, i.e. the consumer's ability to change the supplier of a service, may provide much stronger protection than any administrative law instrument.⁷⁷

It is also pivotal that there is a lack of legitimacy of private actors in governmental functions, in particular actors designing regulation. Private participation in certain government enterprises may also weaken presidential and congressional control by placing public funds, monopolies, or power in the hands of unelected, unappointed, mostly unimpeachable, and largely unaccountable private parties.⁷⁸ Private actions could be constrained by the application of the nondelegation doctrine, which prevents Congress from unconstitutionally delegating its assigned lawmaking power, regardless of whether a public or private actor is involved. The U.S. judiciary seems reluctant to resurrect the nondelegation doctrine in order to invalidate delegations to administrative agencies, commissions, or boards.⁷⁹ Indeed, the U.S. Supreme Court has invalidated private delegations in only a few cases.⁸⁰ State courts are generally upholding laws delegating powers to agencies, and under appropriate

⁷⁶ See Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. Rev. 543, 576-79 (2000) (applying a set of three tests to identify state actions: Joint Participation Test, Nexus Test, or, alternatively, Public Function Test); Barak-Erez, *supra* n. 62, at 1174-83 (arguing that the state action doctrine should be modified and be applied if the service is of a public nature and the state is refraining from operating an equivalent service).

⁷⁷ As pointed out by Mark H. Moore, praising the political model of accountability, some people might disregard this fast possibility of relief ("exit" option), preferring to spend their scarce time complaining to their elected representative, making suggestions in administrative hearings, supported by performance reviews and the mass media ("voice" option). Moore, *supra* n. 42, at 1227.

⁷⁸ See Froomkin, *supra* n. 52, at 548. In rare circumstances, such "private regulators" may be reached with the federal antitrust laws. See Peter Hettich, *Mere Refinement of the State Action Doctrine Will Not Work*, 5 DePaul Bus. & Comm. L.J. 105 (2006).

⁷⁹ *Mistretta v. U.S.*, 488 U.S. 361, 371-79 (1989) (upholding delegation of sentencing guidelines to an independent sentencing commission); *Skinner v. Mid-America Pipeline Co.*, 490 U.S. 212, 218-24 (1989) (upholding delegation to establish a system of user fees to the Secretary of Transportation); *Touby v. U.S.*, 500 U.S. 160, 164-68 (1991) (upholding delegation to add new drugs to schedules of controlled substances to the Attorney General and the Drug Enforcement Administration). Indeed, the Court did invalidate only two statutes as excessive delegations, both in 1935. See *A.L.A. Schechter Poultry Corp. v. U.S.*, 295 U.S. 495, 551 (1935) (invalidating delegation of code-making authority in trade and industry to the President); *Panama Refining Co. v. Ryan*, 293 U.S. 388, 433 (1935) (invalidating delegation of prohibition of interstate and foreign petroleum transport to the President); see also Thomas W. Merrill, *Rethinking Article I, Section 1: From Nondelegation to Exclusive Delegation*, 104 Colum. L. Rev. 2097 (2004); Freeman, *supra* n. 5, at 1304-05.

⁸⁰ See e.g. *Currin v. Wallace*, 306 U.S. 1, 19 (1939) (upholding a provision foreseeing a referendum of tobacco growers for regulation to enter into force); *St. Louis, Iron Mt. & Southern Ry. Co. v. Taylor*, 210 U.S. 281, 296 (1908) (upholding a statute delegating the authority to set standards to the American Railway Association and to the Interstate Commerce Commission); *Carter v. Carter Coal Co.*, 298 U.S. 238, 310-12 (1936) (invalidating a statute penalizing persons who fail to observe certain labor regulations drawn up by majorities of coal producers and employees); see also Harold I. Abramson, *A Fifth Branch of Government: The Private Regulators and Their Constitutionality*, 16 Hastings Const. L.Q. 165, 196-97 (1989); Harold J. Krent, *Fragmenting the Unitary Executive: Congressional Delegations of Administrative Authority Outside the Federal Government*, 85 Nw. U. L. Rev. 62, 62-67 (1990); but cf. *Sunshine Anthracite Coal v. Adkins*, 310 U.S. 381, 397-99 (1940) (upholding the same statute after these powers were shifted to a commission).

circumstances, to private entities, as well.⁸¹ Courts could apply the nondelegation doctrine if inherently governmental functions are concerned. However, the distinction between core and peripheral functions would probably be formalistic, would deny the positive potential of private actions, and would be “out of step” with the functionalist approach required by a modern governance.⁸² Application of the nondelegation doctrine on private actors may invalidate the service contract, and the risk of invalidation may reduce the willingness of private actors to enter into such contracts or may make them ask for an additional risk premium. The establishment of formal oversight, in order to avoid a nondelegation claim, may not necessarily render the private actor adequately accountable.⁸³

With regard to state-owned enterprises, it is disturbing if such an enterprise, such as the USPS, has been delegated the right to circumscribe its scope of business, until recently even the scope of its monopoly rights, thereby affecting other market participants.⁸⁴ Lawmakers should avoid such consolidation of regulatory power and market participation. Economists argue that privatization will replace political accountability with market accountability, i.e. competitive suppliers will prevail and eliminate the poor ones. In general, market accountability by competition works perfectly well in most private markets, where producers and purchasers are both private. Some markets, however, do not produce the necessary information to provide market accountability, and this market failure may be a reason for the government to step in. When the government is contracting with private actors, producing more information may turn out to be insufficient to achieve accountability. The government has to expend vast resources to manage the acquisition process, contract design, and contract surveillance to prevent opportunism.⁸⁵ The government has to find substitutes for the benchmarking process by competition, which is triggered by numerous private purchase decisions.⁸⁶ This *simulation* of market accountability is doomed to fail in cases dealing with bad contract design, incomplete contracts, lack of transparency, and

⁸¹ See Reeder, *supra* n. 54, at 197-217 (analyzing state court decisions regarding nondelegation mainly in Texas; appropriate circumstances for delegation to privates may be the protection against the arbitrary exercise of powers, representation of affected persons, limitation of powers, and no pecuniary or personal interests conflicting with public function).

⁸² *Id.*

⁸³ See Freeman, *supra* n. 5, at 580-86.

⁸⁴ With regard to nonpostal services, sec. 102(2) of the Postal Accountability and Enhancement Act of 2006 (codified as amended 39 U.S.C. § 404(3)) requires the Postal regulatory Commission to review each nonpostal service and to determine whether that service shall continue.

⁸⁵ See Steven J. Kelman, *Contracting*, in *The Tools of Government*, *supra* n. 29, at 282, 285-305, 312-13; Schooner, *supra* n. 4, at 281-89; Dannin, *supra* n. 39, at 268-80 (arguing that cost comparisons between public and private service provision does not take place before contracting, and that overhead, oversight and transferring costs of contracting are neglected); Fruth, *supra* n. 56, at 532-33 (arguing that governments will need to expend greater effort monitoring private contractors than their own employees because privates are able to capture profits from cutting corners; privatization may create more costs than it is likely to save); *Government Contractors*, *supra* n. 24, at 6-7, 60-64; *Privatization*, *supra* n. 40, at 16-18.

⁸⁶ See Guttman, *supra* n. 51, at 325, 341-46 (arguing that modern management and social science techniques such as incentive contracting, competition, and transparency have to be implemented); DeHoog, *supra* n. 43, at 334-35.

lack of oversight capacity. Bad contract design may diffuse responsibilities, set perverse incentives, fail to distinguish clearly between advisory and executive tasks, or fail to bring competencies in line with responsibilities. Transparency and oversight help to ensure the proper execution of a service contract, the quality of service, and the measurement of performance.⁸⁷

Many governmental operations are highly complex, and with complexity, the difficulties of prescribing and assessing quality increase as well. Incomplete contracts are the result, which may deteriorate quality and hamper enforcement of high quality standards. The contractor, who has the best ability to assess quality, also has the least incentive to deliver correct information; this lack of transparency may make forgery of records easy.⁸⁸ For the purchaser it is difficult—impossible if contracting with a new market entrant—to assess the quality of the service *ex ante*. Indeed, while most scholars acknowledge that contracting may save money, findings and conclusions on quality are much more diverse.⁸⁹ It is theoretically possible to obtain the necessary information on quality by investing in expert opinions. Akerlof has pointed out in his famous article:

The purchaser's problem, of course, is to identify quality. The presence of people in the market who are willing to offer inferior goods tends to drive the market out of existence. . . . There may be potential buyers of good quality products and there may be potential sellers of such products in the appropriate price range; however, the presence of people who wish to pawn bad wares as good wares tends to drive out the legitimate business.⁹⁰

Under market conditions without transparency, purchasers will not reward good quality with a higher price, making it impossible for the high-quality offer to compete. At the end of the day, bad quality will prevail. Akerlof mentioned a number of theories to counteract the problem of asymmetric information, such as the provision of guarantees, which shifts the quality risk from the buyer to the seller. Another theory mentioned by Akerlof is to connect a good reputation with brands e.g., food chains and famous educational institutes. Today, a number of private accrediting bodies are producing information and are improving oversight and accountability; these organizations may also reduce the need for regulation

⁸⁷ See Hodge, *supra* n. 3, at 109, 125-28 (citing studies with oversight cost estimates from 2-3% up to 20%; the reliability of these estimates is deemed to be uncertain); Guttman, *supra* n. 51, at 344-46, 356.

⁸⁸ See Dannin, *supra* n. 39, at 253-54 (citing the forgery of water quality reports by a private company operating the sewer system of Ellijay, Georgia).

⁸⁹ See O'Looney, *supra* n. 46, at 26 (arguing that outsourcing causes high transaction costs in services that are complex, experimental, or poorly understood); Hodge, *supra* n. 3, at 129-36, 207-08, 210-11.

⁹⁰ George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 83 Q. J. of Econ. 488, 495 (1970).

in private markets affected by asymmetric information.⁹¹ The government may also accept one industry's own self-regulation or audited self-regulation to support a high service level.⁹² Some accrediting bodies are publishing their own standards, thereby enacting some kind of private regulation. It is probably worth mentioning that private regulatory bodies may be even more overzealous than governmental bodies.⁹³

The position of a government is stronger if the desired service level can be defined properly, allowing enforcement of contract duties or rewards based on performance. Performance-based contracting may induce providers to focus just on performance goals instead of public policy goals.⁹⁴ Operators of private schools, who are rewarded based on their students' grades, will simply distribute more "A's," while other private schools that are rewarded based on the number of their graduating students will not recruit students not from disadvantaged backgrounds. Governments try to counteract perverse incentives by empowering citizens to hold privatized institutions accountable. For example, school vouchers give informed students the ability to choose good institutions and avoid fallible ones.

Where consumers are not able to state their preferences, as in the case of prisons, or where public goods like national defense or lighthouses are affected, oversight of the contractors' work remains a responsibility of the government. Ultimately, the government's power to terminate contracts with non-performing private actors provides accountability. In practice, however, this power is rarely used. In national defense, highly concentrated markets prevent a government from allowing suppliers to fail.⁹⁵ The ability of governments to change contractors diminishes with a smaller number of competitors capable of providing the service. Moreover, ill-designed procurement practices may further reduce the number of competing suppliers.⁹⁶ In other cases, governments may be locked into contracts because of an inability to replace the fallible actor quickly and cost-efficiently, fearing the damage for consumers and the payback of voters in the next elections.⁹⁷ Conversely, governments eagerly giving into public pressure to replace providers can deter investors or cause underinvestment since no one is ready to enter long time commitments under the threat of

⁹¹ Examples to mention are accrediting bodies like the Joint Commission on Health Care and Accreditation of Health Organizations ("JCAHO"), the American Correctional Association ("ACA"), or consumer protection organizations.

⁹² See Freeman, *supra* n. 5, at 613-15, 628-30, 638-43; Dannin, *supra* n. 39, at 274-79.

⁹³ See Hart, *supra* n. 41, at 1149 (describing ACA's several hundred standards).

⁹⁴ See Freeman, *supra* n. 5, at 1291, 1297, 1310-14 (the question remains who should define the service level in case of privatization: either the state by regulation or the customers by market mechanisms).

⁹⁵ See John D. Donahue, *The Privatization Decision: Public Ends, Private Means*, 107-08 (Basic Books, Inc., 1989); see also Steven J. Kelman, *Contracting*, in *The Tools of Government*, *supra* n. 29, at 304-05.

⁹⁶ See Guttman, *supra* n. 51, at 344; Fruth, *supra* n. 56, at 543-45 (stating examples where the government sought to conclude contracts with only one supplier, thereby creating some kind of artificial monopoly).

⁹⁷ See DeHoog, *supra* n. 43, at 329; Reeder, *supra* n. 54, at 221; Fruth, *supra* n. 56, at 525-26.

replacement.⁹⁸

The public and politicians are giving enormous significance to essential services. If privatization or deregulation does not go well, however, the backlash will be against the politicians. Markets suddenly opened to competition after decades of regulation tend to be more turbulent than markets under continued regulation, and may not immediately provide the desired outcome.⁹⁹ Politicians may wish to retain some control over markets, in particular when they are under pressure from incumbent public suppliers or unions predicting social dumping, cream-skimming, huge lay-offs, or a decline in quality. Such politicians may think that regulatory safeguards provide protection from the failures described above, as well as from fraud, service delay, or bankruptcy of the provider. They may hope that at least some of the expected benefits of privatization will appear despite regulation. In Europe, market mechanisms have rarely been given a chance to find equilibrium on their own; as described, public pressure to enact regulation and the will of politicians to do something will be strong shortly after privatization.¹⁰⁰ Ex-ante-regulation may include license requirements, reduced discretion of private actors, reporting duties, monitoring by agencies, conditioned funding, and tort liability.

Governments are suspected of promoting privatization while bypassing public goals like equal treatment or prevention of discrimination based on race, gender, religion, or sexual orientation. Unlike the government, private actors are not generally committed to these goals. Because of their importance, many people probably agree to preserve these goals after privatization, and to “harness” competition by public accountability requirements.¹⁰¹ Scholars discuss the extension of administrative procedures on private actors, such as the Administrative Procedure Act (“APA”)¹⁰² and the Freedom of Information Act (“FOIA”).¹⁰³ Private actors performing certain public tasks have generally not observed the APA’s procedural or FOIA’s disclosure requirements. In some cases, courts have applied minimal common law due process requirements on employers or on associations that interfere with the economic interests of their members.¹⁰⁴ Scholars also argue to amend the traditional command-and-control-mechanisms with contract-based controls, formal and informal, as incentive-based vehicles for the exercise of

⁹⁸ See J. L. Guasch, *Granting and Renegotiating Infrastructure Concessions: Doing It Right*, 60-64 (World Bank Inst. 2004); Werner Troesken & Rick Geddes, *Municipalizing American Waterworks, 1897-1915*, 19 J.L., Econ., & Org. 373, 398 (2003).

⁹⁹ See Kahn, *supra* n. 53, at xviii.

¹⁰⁰ *Id.*; Freeman, *supra* n. 5, at 1330 (stating private prisons, school voucher programs and Health Management Organizations (“HMO”) as examples for intense public outcry).

¹⁰¹ See Minow, *supra* n. 42, at 1230, 1246-48, 1266-70; Guttman, *supra* n. 51, at 344-46 (stressing the importance of oversight to maintain accountability); Tony Prosser, *Social Limits to Privatization*, 21 Brook. J. Intl. L. 213, 221-22 (1995).

¹⁰² 5 U.S.C. §§ 551-559 (1994) (administrative procedure); 5 U.S.C. §§ 701-706 (judicial review) (grants and contracts are excluded from the agencies’ normal rulemaking requirements; judicial review is limited to agencies’ actions; delegation by agencies is not limited, except Congress did so).

¹⁰³ 5 U.S.C. § 552 (2002).

¹⁰⁴ See Freeman, *supra* n. 5, at 586-91.

authority and as instruments of regulation.¹⁰⁵ These requirements diminish the efficiencies expected from private actors, rendering the efforts of privatization partly void. Additionally, the need for enforcement of enacted regulation adds another layer of bureaucracy—the regulatory agency. Nevertheless, it seems reasonable to argue that efficiency and public goals shall not be mutually exclusive, and that a moderate extension of public law norms will not undermine all advantages derived from privatization.¹⁰⁶ The current privatization strategy of the European Union and Switzerland is consistent with this approach to sacrifice some public goals and parts of the efficiency potential. However, all these constructed accountability mechanisms seem no match for market accountability in private markets.

III. POSTAL SERVICES AS MERIT GOODS

Postal services form part of the *essential services* or *services of general interest* described in the previous section. The U.S., the EC, and Switzerland (serving here as an example of a non-member state of the EC) have adopted similar models of market organization for postal services. The following section describes the widespread use of state-owned enterprises, partial monopolies, and additional command-and-control regulation. Postal services are currently subject to major reforms. These changes, however, do not alter the policy goals for postal service, such as affordability and universal access to postal service in rural areas.¹⁰⁷

A. Guarantee of Universal Postal Service

The USPS provides a basic and fundamental service to the people—it is supposed to bind the Nation together through the correspondence of the people. It shall provide prompt, reliable, and efficient services to patrons in all areas and shall render postal services to all communities, even where post offices are not self-sustaining.¹⁰⁸ Rates shall be fair, reasonable, and non-discriminatory.¹⁰⁹ USPS determines the location of post offices.¹¹⁰ It is required to give notice and hold hearings

¹⁰⁵ *Id.* at 549, 574 (Freeman denies the existence of purely private or public realms; she understands the administration, the public realm, as a set of negotiated relationships; agencies shall be able to improve "aggregate" accountability by using private accrediting bodies, regulatory negotiation and other contracts-based instruments); *cf.* José A. Gómez-Ibáñez, *Regulating Infrastructure: Monopoly, Contracts, and Discretion* 157-243 (Harvard U. Press 2003).

¹⁰⁶ See Williamson, *supra* n. 41, at 314 (analyzing the incentives, administrative controls, and performance of markets, hierarchy and hybrid structures); Freeman, *supra* n. 5, at 1290-91, 1339-40; Minow, *supra* n. 43, at 1236-37; *cf.* Wilson, *supra* n. 50, at 326.

¹⁰⁷ *Cf.* United States Postal Service, *Transformation Plan* 76, http://www.usps.com/strategicdirection/_pdf/Conclusion.pdf (Apr. 2002) (holding as conclusion that a commercial "Government Enterprise model can provide the proper mix of commercial pressures and government ownership ... [to] allow the Postal Service, even in the face of increasing competition, to continue achieving its mission—affordable, accessible delivery services for all Americans").

¹⁰⁸ 39 U.S.C. § 101 (1971) (amended 1976, 1993, 1997, 2000, and 2001).

¹⁰⁹ 39 U.S.C. § 403 (1970) (amended 1979).

¹¹⁰ *Id.* at § 404 (1970) (amended 1976 and 1989).

prior to closing or consolidating a post office.¹¹¹ The Postal Rate Commission, in an appeal, has no power to modify a decision to close a post office.¹¹² Until recently, USPS determined the amount of postage to be paid. The Postal Rate Commission had only very limited powers to deny requests of the USPS for changes on domestic rates¹¹³ and mail classifications. The Postal Accountability and Enhancement Act of 2006¹¹⁴ modified the rate setting system. The new Postal Regulatory Commission now has the power to establish a system for regulating rates and classes for market-dominant products like First Class Mail. The USPS still sets the rates for competitive products, such as Expedited Mail and Bulk Parcel Post, provided there are no cross-subsidies from revenues of market-dominant products. Interested parties may lodge complaints with the Postal Regulatory Commission about rates or service.¹¹⁵

The EC guarantees a universal postal service, encompassing a minimum range of services, a specified quality, and affordable prices, irrespective of geographical location.¹¹⁶ The defining elements of this *European* universal service are the number of access points, the frequency of collections and deliveries, the price, and the non-discriminatory provision of service.¹¹⁷ Service guarantees have also been established at national levels.¹¹⁸ Germany prescribes the scope of universal service in detail in its postal act and several regulations.¹¹⁹ The service encompasses the transport of letters up to a weight of 2,000 grams, the transport of packages up to a weight of 20 kilograms, transport of newspapers, registered and insured items, cash on delivery, and express mail. The German postal service has to provide at least 12,000 access points in Germany, with at least one in municipalities with more than 2,000 citizens.¹²⁰ Prices for licensed postal services of market-dominant providers

¹¹¹ *Id.* at § 404(b)(2). In doing so, USPS has to consider the effect of such closing on the community served by the post office, the effect on the employees of the post office, the consistency with the postal policy of the Government, and the economic savings resulting from closing.

¹¹² *Id.* at § 404(b)(3).

¹¹³ The Postal Service established rates of postage or other charges on mail matter conveyed between the United States and other countries with the consent of the President. *Id.* at § 407(b)(2).

¹¹⁴ Pub. L. No. 109-435, 120 Stat. 3198 (2006).

¹¹⁵ Postal Accountability and Enhancement Act of 2006, Pub. L. No. 109-435, sec. 205 (codified as amended at 39 U.S.C. § 3662).

¹¹⁶ Council Directive 97/67/EEC, 1998 O.J. (L 15) 14-25 ¶ 11 (available at <http://www.psc.gov.uk/postcomm/live/legal-framework/postal-legislation/1997-postal-services-directive-as-amended/EUdirective.pdf>).

¹¹⁷ *Id.* at ¶ 3. Universal service in the EC covers one clearance and one delivery every working day and not less than five days a week, save in circumstances of geographical conditions deemed exceptional. It includes the clearance, sorting, transport, and distribution of postal items up to two kilograms and packages up to at least ten kilograms as well as services for registered and insured items. No interruption of service shall occur except in cases of force majeure.

¹¹⁸ Article 87f instructs the lawmakers to care for universal postal and telecommunication services. GG (Grundgesetz) 87f.

¹¹⁹ *Postgesetz* [German Postal Act], v. 22.12.1997 (BGBI I S. 3294); *Post-Universaldienstleistungsverordnung* [German Regulation on Postal Universal Service], v. 15.12.1999 (BGBI I S. 2418).

¹²⁰ In municipalities with more than 4,000 inhabitants, the facility has to be located in a distance of not more than 2,000 meters. One facility has to be operated per area of 80 square kilometers. All municipalities shall have access at least to mobile postal service. Mailboxes have to be made available

are subject to approval by the regulatory authority.¹²¹

Similar to the EC's model, article 92 of the Swiss Constitution¹²² provides a guarantee of sufficient and affordable universal postal and telecommunication services; prices have to be set following uniform principles. Universal postal service in Switzerland includes the handling of postal items every working day and not less than five days a week, except in very difficult geographical circumstances.¹²³ Service must also be provided in all areas of the country, in a uniform manner, in good quality, and for adequate prices.¹²⁴ Additionally, Swiss Postal Service may offer, with approval of the Swiss Government, other services in competition with private actors.¹²⁵ The Swiss Postal Service sets the prices for its service, subject to approval by the Federal Department of Environment, Transport, Energy and Communications ("UVEK") in monopoly areas. Before closing a postal facility, the Postal Service has to hold hearings with the local authorities and has to try to find an amicable settlement. Appeals against closedowns to an independent commission are possible, but the Postal Service has the final decision. Postal Service has to replace closed postal facilities by an alternative solution.¹²⁶

B. State Ownership of Universal Service Providers

Public ownership is common in postal services. The Royal Mail (UK), the Posten AB (Sweden), the Finland Post, the Norway Post, and La Poste (France) were wholly owned by their respective governments in 2007. Denmark owns 75% of Post Danmark and Belgium owns 50% (plus 1 share) of La Poste (Belgium). In November 2006, the Dutch government sold its remaining 10.9% stake in TNT N.V., making it difficult to qualify TNT as a state actor;¹²⁷ nevertheless, TNT operations in the Netherlands are still a creation of national policy, subject to certain privileges and

in distances of not more than 1,000 meters. The regulation describes several quality standards for delivery; delivery has to occur at least once per working day. See *Post-Universaldienstleistungsverordnung* [German Regulation on Postal Universal Service], v. 15.12.1999 (BGBI I S. 2418), §§ 1-3.

¹²¹ *Postgesetz* [German Postal Act], v. 22.12.1997 (BGBI I S. 3294), § 19. See also *infra* n. 161 and accompanying text.

¹²² BV (Bundesverfassung) 101.

¹²³ *Postgesetz* [Swiss Postal Act], v. 22.12.1997 (SR 783.0), art. 2. The service comprehends the handling of letters and parcels up to 20 kg, delivery of subscribed newspapers and periodicals as well as the provision of certain monetary transactions. See *Postverordnung* [Swiss Regulation on Postal Services], v. 26.11.2003 (SR 783.01), art. 2-4, 9.

¹²⁴ Postal Service has to provide a nationwide network of access points in adequate distance of the customer (for 90% of the population), defined as a distance of 20 minutes by foot or public transport. See *PostReg, Tätigkeitsbericht 2005* [Activity Report 2005] 5, 8, <http://www.postreg.admin.ch/imperia/md/content/postreg/berichte/10.pdf> (Jun. 2006) [hereinafter *Activity Report 2005*] (Switzerland operates one postal office per 15.97 square kilometers; Germany, one office per 27.42 square kilometers).

¹²⁵ *Postgesetz* [Swiss Postal Act], v. 22.12.1997 (SR 783.0), art. 9; *Postverordnung* [Swiss Regulation on Postal Services], SR 783.01, art. 10-13. These services include courier services, freight forwarding, packaging of postal items, certain services related to monetary transactions, and procurement of services of private actors. Such services shall not be subsidized with monopoly earnings.

¹²⁶ *Postverordnung* [Swiss Regulation on Postal Services], v. 26.11.2003 (SR 783.01), art. 7-8.

¹²⁷ Cf. Froomkin, *supra* n. 52, at 547-48. See also Sweden Post, *2005 Posten Annual Report* 12-13, <http://hugin.info/134112/R/1053089/175010.pdf> (accessed Feb. 22, 2007).

governmental oversight, and serving—TNT being the universal service provider—a public function.

Congress erected the USPS as an independent establishment of the executive branch of the Government,¹²⁸ and the State owns its assets entirely.¹²⁹ Recently, in *U.S. Postal Service v. Flamingo Industries (USA) Ltd.*, the Supreme Court held that USPS, being part of the U.S. Government, is not amenable to suit under federal antitrust laws.¹³⁰ The Postal Accountability and Enhancement Act of 2006 has abrogated this immunity from the federal antitrust laws, but has not altered the legal character of the USPS as state owned enterprise.¹³¹ The President appoints nine of eleven Governors of the USPS, who appoint the Postmaster General (the CEO of Postal Service).¹³²

Private investors hold the majority of shares of the Deutsche Post AG (Deutsche Post). As of February 20, 2007, the government-affiliated KfW Bankengruppe owned 30.6% of the shares of the Deutsche Post.¹³³ Thus, the influence of the government is still overwhelming.¹³⁴ In addition, there are privileges in favor of Deutsche Post, because it is not required to charge a value-added tax. The Swiss Postal Service, Die Schweizerische Post, is an independent agency of the federal government.¹³⁵ Forming part of the government, the Swiss Postal Service is still a state-owned enterprise. The Federal Government appoints its board of directors for a term of four years and sets the targets of the Swiss Postal Service. The Board, in turn, appoints the Management.

C. Postal Monopoly

USPS enjoys monopoly power over letter delivery and letterboxes. Congress established the letter delivery monopoly in 1792, based on its constitutional power to establish post offices and post roads.¹³⁶ In *ex parte Jackson*, the Supreme Court held that Congress has the power to prohibit the carriage of mail in order to give efficiency to its regulations and prevent

¹²⁸ 39 U.S.C. § 201.

¹²⁹ The USPS has powers like a private legal entity, the power of eminent domain, and the priority of the U.S. in bankruptcy proceedings. *Id.* at § 401.

¹³⁰ 540 U.S. 736; see also *Flamingo Indus. (USA) Ltd. v. U.S. Postal Serv.*, 302 F.3d 985 (9th Cir. 2002), *rev'd*, 540 U.S. 736. Challenges are possible, however, by initiating arbitration proceedings under Chapter 11 of the NAFTA Agreement against the U.S. for failure to comply with the obligations concerning regulation of monopolies (chapter 15); see *United Parcel Serv. of Am., Inc. v. Govt. of Can.*, NAFTA Arb. Trib. (available at <http://www.state.gov/s/l/c3749.htm>).

¹³¹ Pub. L. No. 109-435, 120 Stat. 3198 (2006), sec. 404 (codified as amended at 39 U.S.C. § 409).

¹³² 39 U.S.C. §§ 202-203.

¹³³ See Deutsche Post World Net, *Shareholder Structure*, <http://investors.dpwn.com/en/investoren/aktie/aktionaersstruktur/index.html> (last updated Jan. 18, 2007).

¹³⁴ Cf. *World Bank Group, Bureaucrats in Business: The Economics and Politics of Government Ownership* 26 (Oxford U. Press 1995).

¹³⁵ *Postorganisationsgesetz* [Federal Law on the Organization of the Federal Postal Enterprise], SR 783.1, art. 2.

¹³⁶ U.S. Const. art. I, § 8, cl. 7.

rival postal systems.¹³⁷ The Private Express Statutes circumscribe the monopoly of the USPS.¹³⁸ The monopoly covers the carriage of letters¹³⁹ and packets of two or more letters. It is generally unlawful for any person other than the USPS to send or carry a letter on a post route.¹⁴⁰ The USPS enjoyed the power to suspend the operation of any part of its monopoly where public interest required the suspension,¹⁴¹ giving it important regulatory powers.¹⁴² The most important suspension made was for extremely urgent letters.¹⁴³ The letterbox monopoly allows the USPS to exclude other providers from the use of the customers' letterboxes. Except for newspapers, the use of (private) letterboxes is limited to matter bearing postage.¹⁴⁴ In *U.S. Postal Service v. Greenburgh Civic Assns.*,¹⁴⁵ the Supreme Court considered letterboxes an essential part of the nationwide system for the delivery and receipt of mail, and refused to invalidate the letterbox monopoly on the grounds of a violation of the First Amendment. Letterbox monopolies are unknown in Europe.

¹³⁷ *Ex parte Jackson*, 96 U.S. 727, 735 (1877). The constitutional power vested in Congress covers "not merely the designation of the routes over which the mail should be carried, and the offices where letters and other documents shall be received to be distributed or forwarded, but the carriage of the mail, and all measures necessary to secure its safe and speedy transit, and the prompt delivery of its contents." *Id.* at 732. For the limits of this power, see *Lamont v. Postmaster Gen.*, 381 U.S. 301, 305 (1965) (holding that Congress, while not obliged to operate a postal service, is bound to constitutional guarantees while it carries it on); *Electric Bond & Share Co. v. Sec. Exch. Comm.*, 303 U.S. 419, 442 (1938) (holding that Congress may exercise its control over the mail only within its constitutional province when pertinent to the use of mail).

¹³⁸ 18 U.S.C. §§ 1693-1699; 39 U.S.C. §§ 601-606 (implemented under 39 C.F.R. §§ 310, 320).

¹³⁹ A letter is a message directed to a specific person or address and recorded in or on a tangible object. 39 C.F.R. § 310.1(a) (2005). The courts have generally approved this definition. *Associated Third Class Mail Users v. U.S. Postal Serv.*, 600 F.2d 824, 830 (D.C. Cir. 1979). Telegrams and checks shipped between financial institutions, papers filed in lawsuits, newspapers, periodicals, books, sound recordings, films, packets of identical printed letters to be disseminated in the public, and computer programs are not considered as letters. Letters accompanying cargo, letters of the carrier (intracompany mail), letters carried without compensation, letters carried by a special messenger, and letters carried prior or subsequent to regular mailing are also exempt. 39 C.F.R. § 310.3.

¹⁴⁰ However, private carriage is lawful if the letter is enclosed in an envelope, the letter carries the correct amount of postage, an address, the date of transmission or receipt by the carrier, and the sender has canceled any stamps on the cover. Private carriage is also lawful if in accordance with an agreement with the USPS.

¹⁴¹ Such suspensions include carriage of data processing materials, letters of colleges and universities, certain ocean carrier-related documents, advertisements accompanying parcels or periodicals, international remailing, and extremely urgent letters. 39 U.S.C. § 601(b).

¹⁴² See Geddes, *supra* n. 8, at 89; J. Gregory Sidak & Daniel F. Spulber, *The Nature and Extent of the Postal Monopoly, Protecting Competition from the Postal Monopoly* (Am. Enter. Inst. Press 1996).

¹⁴³ A letter qualifies as "extremely urgent," if its value is lost or greatly diminished, if delivery does not take place within certain time limits, or if the amount paid for private carriage of the letter is at least \$3 or twice the applicable U.S. Postage for First-Class Mail (including Priority Mail), whichever is greater. Additionally, the sender must prominently mark the outside covers of the letter with the words "Extremely Urgent" or "Private Carriage Authorized by Postal Regulations." 39 C.F.R. §§ 320.1-320.9. The Postal Accountability and Enhancement Act, Pub. L. No. 109-435, 120 Stat. 3198 (2006), sec. 503 (codified as amended at 39 U.S.C. § 601(b)) now allows to carry letters out of mail when the amount paid for the private carriage of the letter is at least the amount equal 6 times the rate currently charged for the first ounce of a single-piece First Class Letter.

¹⁴⁴ United States Postal Service, *Domestic Mail Manual* § 508.3.1.3, <http://pe.usps.gov/text/dmm300/508.htm#wp1051804> (accessed Feb. 20, 2006) (incorporated by reference in 39 C.F.R. § 111.1). It is an offense to deposit any mailable matter, on which no postage has been paid, in any letterbox established, and violations are subject to a fine. 18 U.S.C. § 1725 (1948) (amended 1994).

¹⁴⁵ 453 U.S. 114, 128-29 (1981).

In order to ensure the operation of universal service under financially balanced conditions, the EC allows member states to reserve services for public operators. The scope of these reserved services was gradually limited,¹⁴⁶ and since January 2006, has encompassed letters with a weight of up to 50 grams (or postage 2.5 times the standard tariff);¹⁴⁷ the monopoly still covers a large part of mail correspondence.¹⁴⁸ Abolishment of the postal monopoly is likely by 2009. Germany has adopted the Directive's minimum standard and has limited the exclusive right to letters weighing up to 50 grams; the violation of this exclusive right, which the legislature awarded the Deutsche Post, is subject to a fine.¹⁴⁹ Several member states have adopted regulations that are more permissive; Sweden, Finland, Estonia, and Great Britain, have already finished the liberalisation process.

The Swiss Postal Service has the exclusive right to transport letters with an addressee and a weight up to 100 grams;¹⁵⁰ the violation of this exclusive right is an offense.¹⁵¹ The Swiss Government intends to lower the weight limit, as long as the funding of universal service is secured.¹⁵² The monopoly does not cover courier services, defined as letters with a price five times the price of the lowest first class mail postage, and outbound international mail. The monopoly does not cover the transport of mail without compensation, or the transport of mail that the postal service does not handle.¹⁵³ As in the EC, the universal service obligations of the Swiss Postal Service go beyond its monopoly rights.

D. Additional Economic Regulation

With the exception of the postal monopoly (private express statutes), the U.S. does not specifically regulate private providers of postal services; social regulation applying the economy as a whole forms no part of this article.¹⁵⁴

¹⁴⁶ Council Directive 2002/39/EEC, 2002 O.J. (L 176) 21-25.

¹⁴⁷ Council Directive 97/67/EEC, *supra* n. 116, at ¶ 7.

¹⁴⁸ Letters below 50 grams represent, on average, approximately 80% of the total postal revenues of the universal service providers. See Die Bundesnetzagentur [German Federal Network Agency], *Regulierungsbehörde für telekommunikation und Post: Neunte Marktuntersuchung für den Bereich der lizenzpflichtigen Postdienstleistungen* [Regulating Authority for Telecommunications and Post: The Ninth Market Research for the Area of Postal Services Liable to License] 9, <http://www.bundesnetzagentur.de/media/archive/1419.pdf> (Apr. 2006).

¹⁴⁹ *Postgesetz* [German Postal Act], v. 22.12.1997 (BGBI I S. 3294, §§ 49, 51).

¹⁵⁰ *Postverordnung* [Swiss Regulation on Postal Services], SR 783.01, art. 2(1). Seventeen percent of the letter turnover is opened to competition.

¹⁵¹ *Postgesetz* [Swiss Postal Act], v. 22.12.1997 (SR 783.0), art. 3, 19; *Postverordnung* [Swiss Regulation on Postal Services], SR 783.01, art. 1(f). A letter is a postal item of a size not larger than 353 x 250 x 20 mm and a weight not exceeding 1 kg.

¹⁵² See *Basic Supply in the Infrastructure*, *supra* n. 15, at 4572, 4586-87.

¹⁵³ *Postverordnung* [Swiss Regulation on Postal Services], SR 783.01, art. 2(2).

¹⁵⁴ *E.g., Occupational Safety and Health Act*, 29 U.S.C. §§ 651-678 (1970) (which is applicable to any employer including USPS). See *Postal Employees Safety Enhancement Act*, 29 U.S.C. § 652(5) (1970). In contrast to economic regulation, social regulation wants to restrict behavior threatening public health or safety and is not aimed at the competitive process; social regulation may be very strict and may compromise efficiency by setting exorbitant or ineffective standards and by requiring excessive paperwork. See generally Peter J. May, *Social Regulation*, in *The Tools of Government*, *supra* n. 29, at

In the EC, governments may regulate the provision of postal services beyond the scope of universal postal service in order to protect the confidentiality of correspondence, the environment, or to carry out regional planning. Governments may require a license for the provision of non-exclusive postal services (*non-reserved services*, i.e. services within the scope of universal service, but outside the postal monopoly). Such a license may be subject to universal service obligations,¹⁵⁵ to requirements concerning quality, availability and performance of service, and to the obligation not to infringe the exclusive rights of the universal service provider.¹⁵⁶

Implementing the European directive, Germany requires a license to transport letters weighing not more than 1,000 grams.¹⁵⁷ The license is valid for a certain geographical area. The national regulator denies a request for a license if the applicant lacks the efficiency, reliability, or specialized knowledge to exercise the license rights. Further, the regulator will not issue a license for public safety reasons, or if the applicant fails to meet basic working conditions common in the licensed sector.¹⁵⁸ The licensing costs are borne by the applicant. No license is required for the transport of packages or for courier services. The prices of services that form part of the universal service must be cost-based, affordable, and guarantee access for all users.¹⁵⁹ The member states of the EC may apply a uniform tariff throughout their national territory, and the tariffs shall be transparent and non-discriminatory.¹⁶⁰ In Germany, prices of dominant licensees are subject to approval by the regulatory authority; this shall prevent monopoly pricing, predatory pricing, and unjustified discrimination of customers.¹⁶¹ The member states are required to impose quality standards for routing times, regularity, and reliability of the services. These quality standards must be monitored once a year. Transparent, simple, and inexpensive procedures have to be established to deal with users' complaints.

Like the EC, Switzerland requires a license (*concession*) for the

156, 159-60, 177-79 (arguing that aggregate costs and benefits of social and environmental regulations show that, on the whole, these regulations are justifiable).

¹⁵⁵ *Postgesetz* [German Postal Act], v. 22.12.1997 (BGB I S. 3294, § 13). The German regulatory body is competent to impose universal service obligations on providers of postal services if universal service is not appropriately provided and if no company is willing to provide the universal service without payment of compensation.

¹⁵⁶ Council Directive 97/67/EEC, *supra* n. 116, at ¶ 7.

¹⁵⁷ *Postgesetz* [German Postal Act], v. 22.12.1997 (BGB I S. 3294, § 5).

¹⁵⁸ *Postgesetz* [German Postal Act], v. 22.12.1997 (BGB I S. 3294, § 6).

¹⁵⁹ In Germany, prices for postal services are deemed to be affordable if they do not exceed the real price level of December 31, 1997. *Post-Universaldienstleistungsverordnung* [German Regulation on Postal Universal Service], v. 15.12.1999 (BGB I S. 3294, § 6).

¹⁶⁰ Council Directive 97/67/EEC, *supra* n. 116, at ¶ 12.

¹⁶¹ *Postgesetz* [German Postal Act], v. 22.12.1997 (BGB I S. 3294, §§ 19-27); *Post-Entgeltregulierungsverordnung* [German Regulation on the Approval of Rates], v. 22.11.1999 (BGB I S. 2386); *Postdienstleistungsverordnung* [The German Regulation on Postal Services], v. 21.8.2001 (BGB I S. 2178) (embodies some of the service requirements, such as non-discriminatory provision of service by dominant enterprises and an obligation of the universal service supplier to contract. The regulation is based on § 18 of the German Postal Act).

provision of non-reserved postal services (services not covered by the postal monopoly, but within the scope of universal service); applicants attaining a turnover of less than CHF 100,000 do not need a license. The UVEK grants the license if the applicant adheres to applicable law and meets the basic working conditions common in the licensed sector.¹⁶² Further, applicants have to show that they possess the necessary productive and logistic means as well as the necessary know-how for the provision of the service. They have to file information on their intended scope of business, business organization, business plan, and their financial means. In addition, they must show how they intend to meet common working standards. Postal providers must continue to provide this information once a year and during sport tests. They must also provide data on regional employees, range of products, prices, and price structures.¹⁶³ The Swiss Postal Service is not required to apply for a concession. Postal service providers are free to set the prices for their services. However, the UVEK approves prices of the Swiss Postal Service within the scope of the postal monopoly. The quality of universal service provided by the Swiss Post is assessed on a regular basis. Everyone is entitled to file a complaint about quality of and access to universal service.¹⁶⁴ The Swiss Postal Service is entitled to use public property for the provision of universal postal service free of charge.

E. Subsidies for Universal Service Provider

The Government does not reimburse the USPS for providing a universal service. USPS may accumulate deficits, however, but the net increase in the amount of obligations outstanding issued for the purpose of capital improvements and the net increase in the amount of obligations outstanding issued for the purpose of defraying operating expenses of the Postal Service shall not exceed a combined total of \$3 billion.¹⁶⁵ Generally, the government does not guarantee obligations of the USPS; the Secretary of Treasury may pledge the full faith and credit of the U.S. on the obligations if there is a public interest to do so.¹⁶⁶ In 2005, USPS repaid its debt of \$1.8 million; in 2006, USPS ended, for the third time since postal reorganization in 1971, the year with positive retained earnings of \$3.242 million.¹⁶⁷

In the EC, a member state may determine that the universal service obligation represents an unfair financial burden for the universal service provider. To safeguard the provision of the universal service, a member state may establish a fund, in which licensed postal providers have to make

¹⁶² *Postgesetz [Swiss Postal Act]*, v. 22.12.1997 (SR 783.0), art. 5.

¹⁶³ *Postverordnung [Swiss Regulation on Postal Services]*, SR 783.01, art. 20-28.

¹⁶⁴ *Postgesetz [Swiss Postal Act]*, v. 22.12.1997 (SR 783.0), art. 12; *Postverordnung [Swiss Regulation on Postal Services]*, SR 783.01, art. 14-16.

¹⁶⁵ Postal Accountability and Enhancement Act of 2006, Pub. L. No. 109-435, sec. 502 (codified as amended at 39 U.S.C. § 2005(a)(1)).

¹⁶⁶ *Id.* at § 2005(d)(5) (1970); *Id.* at § 2006(c) (1970).

¹⁶⁷ See United States Postal Service, *Annual Report 2006* at 3, http://www.usps.com/financials/_pdf/anrpt2006_final.pdf (accessed Mar. 13, 2007).

financial contributions.¹⁶⁸ In Germany, a licensee may demand compensation from the fund if its long-term incremental costs for providing the universal service exceed its revenues.¹⁶⁹ The licensee's share of the total turnover achieved in the licensed sector determines its contribution. In 2005, the Deutsche Post retained positive earnings in mail services of EUR 2.030 million (EBIT); it received no subsidies. In 2004, the market share in licensed services opened to competition (33% of the mail market) of the Deutsche Post was still 94.9%; the Deutsche Post is still the dominant provider.¹⁷⁰

The Swiss Postal Service has to disclose its costs to provide a universal service. The Postal Service's private competitors may recover any losses in universal service by charging an annual fee on issued licenses. The sales of each provider determine its fee, which is limited to 3% of its turnover in non-reserved services. The Swiss Postal Service is not required to get a license, and therefore, is not required to pay license fees. A private provider may file for a waiver of the fees if it provides postal service in all areas of Switzerland at uniform rates, and if it meets certain quality standards.¹⁷¹ In 2005, the Swiss Postal Service managed to retain positive earnings of CHF 218 million in mail services and CHF 87 million in parcel services.¹⁷² Private providers hold a market share of 18% of the market for parcel services.¹⁷³ No license fees with the purpose to fund universal service are paid at this time.

F. Special Regulatory Body

In the U.S., the Postal Regulatory Commission is an independent regulatory agency. The Postal Accountability and Enhancement Act of 2006 requires the Commission to establish a modern system for regulating rates and classes for market-dominant products of USPS, and to promulgate regulations to restrict USPS's discretion to set rates and classes in the competitive category; the Commission shall prescribe regulations to prevent

¹⁶⁸ Council Directive 97/67/EEC, *supra* n. 116, at ¶ 9(4); *Postgesetz* [German Postal Act], v. 22.12.1997 (BGB I S. 3294, § 12). These funds may not be used to pay cross-subsidies for voluntary undertakings of the universal service provider. No member state of the EC has charged such contributions so far and only a few states have implemented the possibility of contributions, such as Germany, Spain, and Portugal. In Germany, all postal providers with a turnover exceeding EUR 500,000, including the Deutsche Post, have to contribute to the fund. See PostReg, *Tätigkeitsbericht 2004* [Activity Report 2004] 15-16, <http://www.postreg.admin.ch/imperia/md/content/postreg/berichte/1.pdf> (accessed Feb. 23, 2007) [hereinafter *Activity Report 2004*].

¹⁶⁹ *Postgesetz* [German Postal Act], v. 22.12.1997 (BGB I S. 3294, § 15).

¹⁷⁰ See Die Bundesnetzagentur [German Federal Network Agency], *Regulierungsbehörde für telekommunikation und Post: Achte Marktuntersuchung für den Bereich der lizenzpflichtigen Postdienstleistungen* [Regulating Authority for Telecommunications and Post: The Eighth Market Research for the Area of Postal Services Liable to License] 28, 70-72, <http://www.bundesnetzagentur.de/media/archive/1419.pdf> (Apr. 2005) [hereinafter *Regulating Authority for Telecommunications and Post*].

¹⁷¹ *Postgesetz* [Swiss Postal Act], v. 22.12.1997 (SR 783.0), art. 6; *Postverordnung* [Swiss Regulation on Postal Services], SR 783.01, art. 29-36.

¹⁷² See Die Schweizerische Post, *Geschäftsbericht* [Annual Report of Swiss Post] 32, 36 (available at http://www.post.ch/en/uk_gb05.pdf) [hereinafter *Annual Report of Swiss Post*].

¹⁷³ See *Activity Report 2005*, *supra* n. 124, at 21.

unfair competition by USPS.¹⁷⁴

In the EC, each member state designates one or more national regulatory authorities for the postal sector. These are legally separate from and operationally independent of the postal operators. The regulatory body is competent to award licenses, to safeguard the operators' compliance with the obligations under the Community law, and to establish controls and specific procedures to enforce the monopoly. It may also ensure compliance with competition rules in the postal sector. The German regulatory authority for the postal market is the Bundesnetzagentur.¹⁷⁵

Switzerland has established the special regulatory body, PostReg, to provide an independent quality control of the access to universal services and of compliance with the basic principles of cost and performance accounting. PostReg also bans cross-subsidies and handles regulatory complaints.¹⁷⁶ The UVEK, which is subordinated to the government and not independent, grants licenses to private postal service providers.

IV. CONDITIONS FOR SUCCESSFUL PUBLIC-PRIVATE COMPETITION

A. State-owned Enterprises as Policy Instruments

State-owned enterprises are deemed to be an appropriate instrument to carry out programs of a business nature, which are revenue producing, potentially self-sustaining, involve a large number of transactions with the public, and require a greater flexibility regarding budget. Most services of general interest, such as postal services, are suited for public enterprise.¹⁷⁷ State-owned enterprises, in the form of a governmental agency or a separate legal entity, are a very traditional instrument of government. The U.S. Supreme Court has upheld the constitutionality of the Second Bank of the United States in *McCulloch v. Maryland*, finding that despite the lack of an explicit federal power, the government has the power to charter and use a private entity for a public purpose based on the Necessary and Proper Clause.¹⁷⁸

Article 87(3) of the German Constitution vests in the German Parliament the power to charter state-owned enterprises in order to execute federal powers. In a recent case, the Swiss Supreme Court reaffirmed that state-owned enterprises—despite their effect on the competitive process—do not violate the economic liberty established by article 27 of the Swiss

¹⁷⁴ Postal Accountability and Enhancement Act of 2006, Pub. L. No. 109-435, sec. 201, 202, and 403.

¹⁷⁵ *Postgesetz* [German Postal Act], v. 22.12.1997 (BGB1 I S. 3294, § 44).

¹⁷⁶ *Postverordnung* [Swiss Regulation on Postal Services], SR 783.01, art. 41.

¹⁷⁷ See Thomas H. Stanton & Ronald C. Moe, *Government Corporations and Government-Sponsored Enterprises*, in *The Tools of Government*, *supra* n. 29, at 80, 99-100 (quoting President Harry Truman's criteria set forth in 1948).

¹⁷⁸ 17 U.S. 316, 409-12 (1819); see also *Osborn v. Bank of the U.S.*, 22 U.S. 738, 859-60 (1824); *Luxton v. N. Bridge Co.*, 153 U.S. 525, 529 (1894); *Smith v. Kansas City Title & Trust Co.*, 255 U.S. 180, 208-09 (1920); *Ashwander v. Tenn. Valley Auth.*, 297 U.S. 288, 338-339 (1936); *Fed. Land Bank v. Bismark Lumber Co.*, 314 U.S. 95, 102-03 (1941); *Pittman v. Home Owners' Loan Corp.*, 308 U.S. 21, 32-33 (1939).

Constitution.¹⁷⁹ Economists generally consider public ownership of enterprises as evil; the reasons outlined in subsection II.C) might make us agree with them. There is no reason at all to establish or maintain public ownership if markets work properly. Even if state-owned enterprises performed as efficient as private enterprises, governments should prefer competitive market configurations, economic freedom, and private initiative.¹⁸⁰ Public enterprises may be justified to carry out some public policy, but should not be established for the reason to make profit.¹⁸¹

Empirical evidence on the performance of state-owned enterprises is mixed.¹⁸² There are some indications that the private sector is outperforming state-owned enterprises, in particular if these bureaucracies remain unchallenged by competitors; however, inefficiencies would occur in a private monopoly as well. There is some evidence that state-owned enterprises may act efficiently under competitive pressure or under the threat of replacement. Surveys revealed that state-owned enterprises facing private competitors are able to lower costs significantly, and they may even charge the same prices as for-profit firms.¹⁸³ Lack of competitive pressure

¹⁷⁹ *Assoc. of Priv. Hosp. of Zurich v. St. of Zurich*, unpublished decision of the Federal Supreme Court 2P.67/2004 (Sept. 23, 2004) (available at <http://www.bger.ch>). The only requirement to establish a public enterprise in Switzerland is a sufficient legal basis; however, the Swiss Supreme Court refuses to scrutinize claims about an insufficient legal basis.

¹⁸⁰ See Froomkin, *supra* n. 52, at 581.

¹⁸¹ See e.g. Trebilcock & Iacobucci, *supra* n. 29, at 1429-30.

¹⁸² See Fruth, *supra* n. 56, at 534-35; Hart et al., *supra* n. 41, at 1147 (arguing that cost advantages in private prisons derive from lower wages for private guards); William L. Megginson & Jeffrey M. Netter, *From State to Market: A Survey of Empirical Studies on Privatization*, 39 J.L. & Econ. 321 (2001) (finding evidence for economically superior private sector performance, giving an overview on other empirical studies); Hodge, *supra* n. 3, at 5; Harvey L. Reiter, *Competition between Public and Private Distributors in a Restructured Power Industry*, 19 Energy L. J. 333, 342-43 (1998) (holding that there is no consensus that private electric utilities are more efficient); Trebilcock & Iacobucci, *supra* n. 29, at 1424-27; Stacey R. Kole & Mulherin Harold, *The Government as a Shareholder: A Case from the United States*, 40 J.L. & Econ. 1, 16-17 (1997) (finding no difference in performance); World Bank Group, *supra* n. 134, at 97-100 (arguing that the more private involvement, the better performance); Boardman & Vining, *supra* n. 50, at 7-8, 26 (arguing that most studies analyze state-owned enterprises in monopolistic environments, but finding superiority of private companies also in competitive environments; mixed enterprises are often worse than state-owned ones in terms of profitability); William J. Hausman & John L. Beufeld, *Property Rights Versus Public Spirit: Ownership and Efficiency of U.S. Electric Utilities Prior to Rate-of-Return Regulation*, 73 Rev. of Econ. & Statistics 414, 419-421 (1991) (finding large and significant differences in efficiency in support of municipal electric utilities); Pradeep Chhibber & Sumit K. Majumdar, *State as Investor and State as Owner: Consequences for Firm Performance in India*, 46 Econ. Dev. and Cultural Change 561, 574-75 (1998) (arguing that mixed enterprises in competitive environments match private companies); George A. Boyne, *Bureaucratic Theory Meets Reality: Public Choice and Service Contracting in U.S. Local Government*, 58 Pub. Administration Rev. 474, 482 (1998) (arguing that studies struggle with evidence on public choice claims of efficiency gains and cost savings by contracting). In contrast to the World Bank studies cited above, causes different from ownership, such as nepotism and corruption, may explain bad performance results of public enterprises retrieved in developing countries. In Switzerland, monopolized public building insurances charged lower rates than private companies since they could spare advertisement costs for their mandatory service and had access to cheaper sources of funding (benefiting from the credit of the state). See Sekretariat der Wettbewerbskommission [Swiss Competition Commission], *Gebäudeversicherung in den liberalisierten Kantonen* [Building Insurance in Liberalized States] 2003/4 RPW [Law & Policy on Competition] 741-752 (available at <http://www.weko.admin.ch/publikationen/00212/rpw03-4.pdf?lang=de>).

¹⁸³ See Kathryn L. Dewenter & Paul H. Malatesta, *State-Owned and Privately Owned Firms: An Empirical Analysis of Profitability, Leverage, and Labor Intensity*, 91 Am. Econ. Rev. 320, 332-34 (2001) (These authors confirm that empirical evidence on the performance of public enterprises is

may be the cause of inefficiency of state-owned enterprises, not organization or ownership.¹⁸⁴

As outlined above, this article analyzes the use of state-owned enterprises under the assumption of inevitable intervention in markets of essential services. As the following will explain, a state-owned enterprise competing with private actors is a more efficient way to achieve public goals compared to the currently favored combination of instruments, and such competition may substitute regulatory safeguards.¹⁸⁵

B. State-owned Enterprises as Promoters of Public Goals

By definition, private performance falls short of the desired ideal in *merit good* markets. Alfred Kahn was the first to state that performance may be improved by providing a government yardstick of actual or potential public-private competition. He argued that competition between the public and private system of organization may take place by direct rivalry (for customers in the same market) or by setting an example (allowing comparisons between public and private performance in different markets).¹⁸⁶ In essential services, yardstick-competition may be adapted to trigger mutual performance benchmarking, giving state-owned enterprises incentives to improve efficiency, and pressuring private entities to consider public policy.

Like any private owner making use of his property according to his preferences, governments may determine the use of their enterprises. Governments may order their enterprises to provide services in rural areas, lower rates for elderly or handicapped people, employ senior employees, or broaden the range of offered products.¹⁸⁷ It seems highly probable that public and private enterprises will not offer exactly the same products in essential services. The network of postal facilities of a public provider may be more expensive, but may also cover the whole country, including rural

mixed. In their sample, however, they find government-owned enterprises significantly less profitable; in their view, however, privatization itself does not increase profitability; governments are able to organize their firms efficiently in the three years before privatization. They conclude that the rationale for privatization may be to perpetuate efficiency gains). See also Anthony E. Boardman & Aiden R. Vining, *supra* n. 50, at 26; but see Donahue, *supra* n. 95, at 62-64 (analyzing studies of municipal garbage collection, which showed significant cost advantages for private contractors, while public enterprises and private monopolies charged the highest collection fees).

¹⁸⁴ See, e.g., Hodge, *supra* n. 3, at 108-09 (arguing that even neighboring to areas where competition is occurring increases efficiency of public enterprises); Kahn, *supra* n. 53, at 103-04; but see Raymond M. Duch, *Privatizing the Economy: Telecommunications Policy in Comparative Perspective* 36-40, 259-60 (1991) (arguing that governments exercising political control over management decisions affect performance adversely); Boardman & Vining, *supra* n. 50, at 7-8, 26 (finding that large industrial mixed and state-owned enterprises perform substantially worse than private companies in competitive environments).

¹⁸⁵ See also Kahn, *supra* n. 53, at 105; Froomkin, *supra* n. 52, at 579.

¹⁸⁶ *Id.* at 104. The term "yardstick competition" sometimes refers only to competition by example, e.g. when comparing the performance of two or more regional monopolies. See World Bank Group, *supra* n. 134, at 110.

¹⁸⁷ Even most committed proponents of private markets concede the power of the government to regulate its own property. See James R. Edwards, *Regulation, the Constitution, and the Economy* 123 (U. Press of Am. 1998) (objecting all regulation except where the government exerts property rights); cf. Donahue, *supra* n. 95, at 59.

areas. Private courier services may be ready to pick up the mail, but charge a higher fee.

Consumers choose the provider who maximizes their net surplus. This may be the provider with the highest reputation, but not necessarily the cheapest provider, which is presumably the private enterprise. Postal markets with public-private competition are likely to enter into a multi-price equilibrium if products are heterogeneous, information is imperfect, consumer preferences are distinct, and the number of competitors is limited or competition is localized.¹⁸⁸ Product differentiation and monopolistic competition in equilibrium will not result in maximum efficiency, as achieved by perfect competition.¹⁸⁹ However, markets do not reach maximum efficiency when governments artificially increase output by command-and-control regulation or contracting.¹⁹⁰ Thus, if intervention occurs anyway, public enterprise remains a valid option to pursue policy goals under efficiency considerations.

The struggle to maintain accountability over privatized entities shows¹⁹¹ that the best-suited instrument to pursue policy goals is not easy to determine. Contracting with private service providers may not render the desired results if the task is difficult to define, compliance with the contract is difficult to enforce, or regulators may not anticipate the future needs of consumers and investors accurately.¹⁹² Governments have to spend significant resources to design contracts and to ensure compliance, which partly devours the benefits of privatization.

In contrast to contractual or regulatory duties imposed on private enterprises, the state-owned enterprise acts as a direct instrument. This directness mitigates the principal-agent problems typically induced by contracts or regulation.¹⁹³ Private contractors have incentives to lower quality in order to maximize profits. In non-transparent markets, low quality may even prevail. The presence of a state-owned enterprise may overcome these problems even if the public provider holds only a small share of the market (fringe firm).¹⁹⁴ The state-owned enterprise will set a

¹⁸⁸ See generally Jeffrey M. Perloff & Steven C. Salop, *Equilibrium with Product Differentiation*, 52 Rev. of Econ. Stud. 107, 108-10, 113-15 (1985); Harold Hotelling, *Stability in Competition*, 39 Econ. J. 41, 43-44 (1929) (introducing a spatial model of competition); Edward H. Chamberlin, *The Theory of Monopolistic Competition: A Re-orientation of the Theory of Value* 56-70 (7th ed., Harvard U. Press 1956) (introducing a representative consumer model permitting multi-brand competition).

¹⁸⁹ The strict preconditions of perfect competition are never met in reality; scholars also acknowledge that perfect competition (perfect knowledge and foresight, perfect standardization, infinite number of sellers and buyers) is not desirable because it may stall innovation (dynamic perspective); see e.g. Hettich, *supra* n. 44, at 347, 361-62.

¹⁹⁰ In case of market failures (public goods, externalities, etc.), however, contracting or regulation may be the only way to trigger private provision of services that are not sustainable in the market.

¹⁹¹ See *supra* pt. II(D).

¹⁹² See Donahue, *supra* n. 95, at 222-23; Gómez-Ibáñez, *supra* n. 105, at 343, 349-52.

¹⁹³ However, similar principal-agent problems exist on the level of taxpayer-government, already.

¹⁹⁴ Vertical integration in the private economy is generally regarded as efficient because it abolishes transaction costs in long-term contractual relationships caused by the need of good contract design and mutual oversight during the contract. Of course, private economy concepts may not necessarily be true for the public sector.

minimum quality standard, threatening private enterprises not meeting this standard with displacement. It will preserve in-house expertise, which helps the government to assess quality and costs of private competitors more easily, and reduces oversight costs. Private actors will engage in oligopolistic behavior or collusion in rural areas where markets may sustain only a few competitors, even if competition is fierce in urban areas. If the public provider acts as a competitive fringe firm, collusion is less likely.¹⁹⁵

Governments may direct their enterprises to set a cost-based price, pressuring private firms to meet competition. State-owned enterprises might be more willing than private enterprises to take the risk of long-term investments.¹⁹⁶ State-owned enterprises, properly managed and with a clearly stated mission of the government,¹⁹⁷ may demonstrate more commitment to equity considerations, and will deliver its services on a nationwide basis to all customers without discrimination. Some governments may force private actors to lower prices and to provide nationwide service by enacting command-and-control regulation.

In contrast to this coercive instrument of governmental control, the benchmark of a state-owned enterprise sets incentives for desired behavior, leaving private actors free to follow the example or not. Such governance by incentives preserves the competitive process because private market participants remain unrestrained by coercive regulation.¹⁹⁸ Private actors will continue to carry innovative and successful strategies into the markets. The state-owned enterprise may decide to follow suit; it may also cease to offer some services, which are undesired by the public even under a *merit good* perspective.

There are examples in which state-owned enterprises were able to set a benchmark of desired behavior for private market participants. In the U.S., the presence of municipal power utilities that are ready to provide certain additional services tailored to local needs may have induced private

¹⁹⁵ See Kip W. Viscusi et al., *Economics of Regulation and Antitrust* 162-65 (3rd ed., MIT Press 2000); Frederic M. Scherer & David Ross, *Industrial Market Structure and Economic Performance* 224-25 (3rd ed., Houghton Mifflin Co. 1990); Hettich, *supra* n. 44, at 383; Jeffrey Church & Roger Ware, *Industrial Organization: A Strategic Approach* 124-26 (McGraw-Hill 2000).

¹⁹⁶ In Switzerland, 55.9% of electricity was produced by hydropower in 2003, the respective facilities were built by public enterprises; still today, 81.1% of the equity of these enterprises is owned by the public; Bundesamt für Energie [Swiss Federal Office of Energy], *Schweizerische Elektrizitätsstatistik 2003* [Electricity Statistics 2003] 3, 43, http://www.bfe.admin.ch/php/modules/publikationen/stream.php?extlang=de&name=de_379324429.pdf (accessed Feb. 24, 2007). Hydroelectric power plants need decades to break even. Private companies would have been more likely to choose gas power plants, which break even faster and face lower initial investments, but higher operative costs. See also Gregory J. Sidak, *Remedies and the Institutional Design of Regulation in Network Industries*, 2003 Mich. St. DCL L. Rev. 741, 753 (2003) (arguing that an unbundling requirement in less-developed countries will deter American foreign investment there); Barry Bozeman, *All Organizations are Public: Comparing Public and Private Organizations* 137 (Jossey-Bass Inc. 1987) (arguing that the higher levels of publicness result in longer-range planning horizons, based on a case study of R&D organizations).

¹⁹⁷ See *infra* pt. F) for concerns regarding proper management of public enterprises.

¹⁹⁸ Such as corrective pollution taxes or permit trading. See e.g. Joseph J. Cordes, *Corrective Taxes, Charges, and Tradable Permits*, in *The Tools of Government*, *supra* n. 29, at 255, 268-69.

companies to set a higher service standard as well.¹⁹⁹ In his empirical study on the electric utility industry, Hellman concluded that competition between private and state-owned enterprises has been a much more powerful instrument to achieve price reductions, sales promotions, and extensions of service than regulation has been.²⁰⁰ Louis D. Brandeis's plan for mutual savings banks to sell life insurance at favorable rates in competition with insurance companies forced the latter to lower their rates, although market entry occurred only at a small scale in the beginning.²⁰¹

A strong case for providing market discipline is Alexander Hamilton's First Bank of the United States, chartered by the U.S. in 1791. This governmental undertaking was very successful. The Bank, besides regular banking, provided a safe paper currency. As a creditor of many state banks and by its policy of refusing notes of non-specie-paying banks, it drove out fiat money and kept paper money at its face value. Further, it restrained excessive lending of state banks by turning in their papers for payment in specie, thereby reducing their reserves.²⁰² In all these cases, private actors provided more benefits to their customers, at the expense of shareholders and creditors. They produced the desired merit good voluntarily.

In the past, the lacking threat of bankruptcy or take-over induced state-owned enterprises to slack off. In public-private competition, however, a public provider faces a threat of total displacement by more efficient, private providers. A state-owned enterprise will recognize that its government may carry on easily without them, should they fall short of performance, or should private providers do a better job in the pursuit of public goals.²⁰³ This shows that the benchmark works bidirectional. Just as private actors are pressured to pursue public goals, state-owned enterprises are pressured to operate more efficiently.

Recent developments show that state-owned enterprises are not readily taking the place as guardians of public goals. Several studies of USPS pricing show that USPS applies monopoly pricing for First Class Mail in order to cross-subsidize other services (mail classes). At this point, it is difficult to assess the anticompetitive behavior of the USPS because of

¹⁹⁹ See Reiter, *supra* n. 182, at 348; Kahn, *supra* n. 53, at 103; but see H.R. Jud. Comm., *The Application of the Antitrust Laws to the Tennessee Valley Authority and the Federal Power Marketing Administrations*, 105th Cong. 69-87 (1997) (statements of W. David Fletcher, Chairman, Bristol Virginia Utility Board, and David L. Sanders, general counsel to 4-County Electric Power, testifying abusive behavior by TVA after loosing a contract to supply energy, such as predatory pricing, threatening to refuse access to interchange facilities, demanding damages to be paid as stranded costs, intimidating locals by publishing false statements); R. Richard Geddes, *Case Studies of Anticompetitive SOE Behavior*, in *Competing with the Government*, *supra* n. 8, at 45-48.

²⁰⁰ See Richard Hellman, *Government Competition in the Electric Utility Industry: A Theoretical and Empirical Study* (Praeger 1972).

²⁰¹ See Philippa Strum, *Louis D. Brandeis: Justice for the People* 88-89 (Harvard Univ. Press 1984).

²⁰² See Edward S. Kaplan, *The Bank of the United States and the American Economy* 19-35 (Greenwood Press 1999); Susan Hoffmann, *Politics and Banking: Ideas, Public Policy, and the Creation of Financial Institutions* 21-43 (John Hopkins Univ. 2001); Margaret G. Myers, *A Financial History of the United States* 68 (Columbia Univ. Press 1970).

²⁰³ See Kahn, *supra* n. 53, at 104.

its only recently abrogated immunity from antitrust lawsuits.²⁰⁴ Nevertheless, the recent decision in *U.S. Postal Service v. Flamingo Industries* provides some interesting insights.²⁰⁵ According to the allegations of Flamingo's complaint, the USPS terminated Flamingo's contract because it wanted to use cheaper mail sacks manufactured in Mexico.²⁰⁶ To disguise this scheme, the Postal Service adopted outdated requirements for mail sacks that could not be met by the modern machines used by Flamingo and other domestic manufacturers.²⁰⁷ This created a pretext for cancelling the domestic mail sack contracts.

Once those contracts were cancelled, the USPS falsely declared an emergency in the supply of mail sacks, allowing it to award future contracts to foreign manufactures on a no-bid basis. Precedents reveal that such a sudden change of standards may constitute a violation of the antitrust laws.²⁰⁸ Further, the USPS has the power to investigate postal offenses, search vehicles or stores for mail matter, and seize letters. These powers create a conflict of interest and may be a powerful instrument to hamper its competitors.²⁰⁹ The USPS is also competing with private actors in markets beyond postal service, which is not justified by *merit good* considerations.²¹⁰

The Deutsche Post has been subject to several antitrust investigations by the European Commission. In a recent case, the Commission took action against Germany because its postal regulatory framework induced the Deutsche Post to discriminate against mail preparation firms. While large senders are allowed to feed self-prepared mail directly into sorting centers and are granted discounts for doing so, commercial mail preparation firms are barred from discounts for mail preparation.²¹¹ The Commission's decision was aimed at the Germany government. Germany appealed the decision on December 12, 2004, but the German competition authority, the Bundeskartellamt, enacted measures against the Deutsche Post in a parallel proceeding.²¹² In 2001, The European Commission found that the Deutsche Post has abused its dominant position in the German letter market by intercepting, surcharging,

²⁰⁴ *Flamingo Indus. (USA) Ltd.*, 540 U.S. 736.

²⁰⁵ 302 F.3d 985 (9th Cir. 2002), rev'd, 540 U.S. 736.

²⁰⁶ *Id.* at 985-86.

²⁰⁷ *Id.* at 985-86.

²⁰⁸ *Automatic Radio Mfg. v. Ford Motor Co.*, 390 F.2d 113 (1st Cir. 1968); see also Hettich, *supra* n. 44, at 394-96.

²⁰⁹ 39 U.S.C. §§ 404, 603-604.

²¹⁰ See Geddes, *supra* n. 8, at 90-97; John T. Tierney, *Postal Reorganization: Managing Public's Business* 130 (Auburn House 1981).

²¹¹ Decision of the European Commission, *BdKEP/Deutsche Post AG & Bundesrepublik Deutschland v. European Communities*, COMP/38.745 (2004) (available at <http://ec.europa.eu/comm/competition/antitrust/cases/decisions/38745/en.pdf>).

²¹² Decision of the German Federal Cartel Office [Bundeskartellamt], *Deutsche Post AG v. DID Deniz Intelligente Dienstleistungen et al.*, B 9 – 55/03 (February 11, 2005) (available at <http://www.bundeskartellamt.de/wDeutsch/download/pdf/Kartell/Kartell05/B9-55-03.pdf>).

and delaying incoming international mail, which the Deutsche Post erroneously classified as circumvented domestic mail.²¹³

In the same year, UPS succeeded in a complaint against the Deutsche Post. The European Commission found that the Deutsche Post abused its dominant market position by granting fidelity rebates and engaging in predatory pricing in the market for parcel services. In order to avoid further cross-subsidization of parcel services with the revenues from the monopoly in the letter market, the Deutsche Post agreed to create a separate legal entity for parcel services. It was fined EUR 24 million for the foreclosure of the market resulting from fidelity rebates.²¹⁴

In 2000, the Commission initiated proceedings against Deutsche Post because of an alleged abuse of a dominant market position. This was in response to numerous complaints and to a judgment of the European Court of First Instance finding that the Commission had wrongly failed to act in the matter. According to the Commission's inquiries, the Deutsche Post allows large mail-order traders substantial discounts if they choose the Deutsche Post as their exclusive provider. The Commission found that the Deutsche Post sells its mail-order parcel services below cost, with the result that no private provider of parcel services for mail-order firms has been able to gain a substantial market share. Further, the Deutsche Post charges the highest fees for letters delivered under its monopoly rights in Europe.²¹⁵

A 2003 study by the National Economic Research Associates ("NERA"), analyzing postal pricing, found excessive rates of return in the Deutsche Post's mail division even after taking into account the costs of universal service.²¹⁶ In addition, the Deutsche Post has aggressively expanded its business. Since its partial (and later complete) take-over of DHL, the Deutsche Post subsequently acquired other providers of postal and logistics services. Some of these providers include Danzas, the U.S.-based international freight forwarder, Air Express International, and Securicor and Exel, U.K.-based providers. Without success, the Deutsche Post sued competitors for naming their services *postal*.²¹⁷ It also unsuccessfully sued smaller providers of courier services for alleged

²¹³ Decision of the *European Commission, British Post v. Deutsche Post AG*, COMP/36.915 (2001) (available at http://eur-lex.europa.eu/LexUriServ/site/en/oj/2001/l_331/l_331200111215en00400078.pdf).

²¹⁴ Decision of the *European Commission, United Parcel Service v. Deutsche Post AG*, COMP/35.141 (2001), (available at http://eur-lex.europa.eu/LexUriServ/site/en/oj/2001/l_125/l_12520010505en00270044.pdf).

²¹⁵ Decision of the *European Commission, DVPT v. Deutsche Post AG*, COMP/37.821 (2000) (available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/00/919&format=HTML&aged=0&language=EN&guiLanguage=en>).

²¹⁶ See National Economic Research Associates, *The Profitability of the Mail Division of the Deutsche Post: A Report for UPS* 36-37, <http://www.postcom.org/public/2003/nerareport.pdf> (Mar. 2003). Despite this, complaints about bad service are increasing, and some of the Deutsche Post's cheap contractors have been caught searching mail for valuables or simply disposing the mail in a nearby pond. See Felix Kurz, *Letters in Ponds* [Briefe im Weiher], *Der Spiegel* 58 (May 23, 2005).

²¹⁷ Decision of the *State Court of Appeals Koeln [Oberlandesgericht Koeln], Deutsche Post AG v. PIN AG*, 33O23/04 (Jan. 28, 2005).

infringements of its monopoly.²¹⁸ Further, the Deutsche Post is exempt from charging a value-added tax in postal services, in contrast to private providers.²¹⁹ Value-added taxes in Germany amount to 19%²²⁰ and therefore, the tax exemption results in a significant advantage in price competition.

Even the smaller Swiss Postal Service has a record. In December 1999, the Swiss Postal Service refused to ship pamphlets of an association concerned with animal rights; the postal service claimed that it is not obliged to provide the service, that it may discriminate between customers, and that the distribution of the pamphlet would damage its reputation. The Swiss Supreme Court, when deciding the case, held that the Swiss Postal Service is acting against morality when it denies access to services offered in the market without good reason.²²¹ The court did not decide this case on grounds of free speech; sadly, the court held that the Swiss Postal Service is not obliged to respect fundamental rights when distributing pamphlets.²²² From an economic perspective, the described conduct is a departure from rational market behavior. The Swiss Postal service is authorized by law to carry out financial services in competition with banks and insurance companies. It conducts businesses barely related to postal services, such as facilities management and the sale of electronic equipment, newspapers, and bags. Further, the Swiss Postal Service is exempt from taxes with regard to universal service,²²³ and turnover in monopolized postal services is exempt from a value-added tax.²²⁴

Reports indicate anticompetitive behavior of public postal service providers in other countries as well.²²⁵ Such behavior is, however, not a phenomenon limited to postal service. Surveys show that state-owned enterprises have stronger incentives for anticompetitive behavior than private ones. As shown above, state-owned enterprises make frequent use of predatory pricing (below-cost pricing funded by cross-subsidies from monopolized services). They raise their rivals' costs by filing lawsuits or lobbying for regulatory constraints. They aggressively defend market shares and exclusive rights, discriminate between competitors and

²¹⁸ Decision of the *State Administrative Court Koeln* [*Verwaltungsgericht Koeln*], *Deutsche Post AG v. X and Y GmbH*, 22K5502/98 and 22K6821/98 (Jun. 29, 1999).

²¹⁹ *Umsatzsteuergesetz* [German Act on Value Added Tax], v. 26.11.1979 (BGBl I 1953, § 4(11b)).

²²⁰ *Umsatzsteuergesetz* [German Act on Value Added Tax], v. 26.11.1979 (BGBl I 1953, § 12, as amended by law of 13.12.2006 (BGBl I 2878)).

²²¹ *Verein gegen Tierfabriken v. Die Schweizerische Post*, BGE 129 III 35, 47 (2002). The case seems to have been better decided on the grounds of antitrust law, i.e. of an abuse of a dominant market position, than on grounds of a violation of morality. The abolition of the Swiss monopoly dates back only to January 2004, which is probably not enough time to build a comprehensive case record.

²²² *Id.*

²²³ *Bundesgesetz vom 30. April 1997 über die Organisation der Postunternehmung des Bundes* [Federal Law on the Organization of the Federal Postal Enterprise], SR 783.1, art. 13.

²²⁴ *Mehrwertsteuergesetz* [Federal Law on Value Added Tax], SR 641.20, art. 18(1). In contrast to German regulation, this does not put competitors at a disadvantage.

²²⁵ See Geddes, *supra* n. 8, at 102-06.

customers, and expand their business in unregulated sectors.²²⁶

It is surprising that the First Bank of the United States, mentioned above as a successful example of public-private competition, did not try to drive out private banks or to establish a monopoly. Political meddling in this Bank was very moderate because private shareholders appointed the bank's 25 directors; the bank had few incentives to engage in unprofitable predatory strategies.²²⁷ The bank protected its assets by turning in foul money; but at the same time, this furthered the public interest in a stable currency. Such harmony between public and private interests seems rare.

In postal markets, public providers are required to provide universal service at fair and equitable prices, maintain good working conditions, and be aware of social responsibility. At the same time, governments expect public postal providers to sustain a competitive environment and to draw profits. Faced with these contradictory goals and declining mail volumes, the public provider has to keep a large part of its market share to maintain revenues and avoid large lay-offs.²²⁸ Thus, it is not surprising that it engages in anticompetitive behavior. The government may mitigate this conflict by giving priority to its policy goals. These policy goals are, after all, the government's justification for public enterprise.

Applying the *merit good* rationale, profits of a state-owned enterprise should be used to expand service or to lower prices.²²⁹ It seems misguided to use these profits for the Treasury because it amounts to a tax on the consumption of essential services. A government not expecting contributions to its treasury from its enterprises' (monopoly) earnings may be more ready to continue reducing regulatory constraints. Earnings of state-owned enterprises become, particularly in times of tight money, a strong argument to stop deregulation and to maintain protection from

²²⁶ See David E. M. Sappington & Gregory J. Sidak, *Competition Law for Enterprises*, 71 Antitrust L.J. 479, 522-23 (2003); Ulf Böge, *Recent Regulations for the Abusive Conduct of Market Dominating Enterprises*, 3 Wash. U. Global Stud. L. Rev. 429, 433 (2004) (describing that a subsidiary of the Deutsche Bahn AG, which is a state-owned company and the dominant operator of the railway network in Germany, incurred 25% lower costs for using tracks than its private competitors); Lester M. Salamon, *Economic Regulation*, in *The Tools of Government*, *supra* n. 29, at 149 (arguing that refusals of requests for interconnection in telecommunications is a typical behavior of incumbent firms); Troesken & Geddes, *supra* n. 98, at 381-84 (arguing that American municipalities started competing against their franchised private waterworks by building their own facilities).

²²⁷ Such insulation from politics and lack of accountability may also be a cause for anticompetitive behavior. See generally Froomkin, *supra* n. 52, at 557-58, 560-61.

²²⁸ This corresponds with the economic theory that instruments have to match the amount of policy goals, at least. See Jan Tinbergen, *Economic Policy: Principles and Design* 53-56 (Rand McNally 1956); Helga Luckenbach, *Theoretische Grundlagen der Wirtschaftspolitik [Theoretic Basic Principles of Economic Policy]* 357 (2nd ed., Vahlen 2000); cf. World Bank Group, *supra* n. 134, at 3 (arguing that bad performance is caused by contradictory goals and perverse incentives). The cited examples indicate also that mixed enterprises, in contrast to the assumption of Catherine C. Eckel & Aidan R. Vining would not lead to improved efficiency and more socially optimal output. See Catherine C. Eckel & Aidan R. Vining, *Elements of a Theory of Mixed Enterprise*, 32 Scottish J. Pol. Econ. 82, 88-92 (1985). With their mission to accomplish two contracting goals, mixed enterprises would probably either concentrate on one goal or accomplish none of them.

²²⁹ See also *Georg Mueller v. State of Aargau*, BGE 124 I 11, 19-23 (holding that a monopoly retaining positive earnings has to fulfill the same premises as a tax; according to the court, this is not true if the positive earnings are insignificant).

competition.²³⁰ The government avoids its conflict of interest as both market regulator and enterprise owner if the state-owned enterprise makes no profit. The performance benchmark of private postal providers will be sufficient to keep the state-owned enterprise from generating losses.

A further decline in traditional postal services, however, may diminish the possibility of the state-owned enterprise funding public goals. The state-owned enterprise might eventually call for subsidies or other privileges. Such privileges can heavily distort competition, which drastically is displayed, for example, by the market for conforming residential mortgages. Many government-sponsored enterprises enjoy an implicit government guarantee; Fannie Mae and Freddie Mac²³¹ borrow money at interest rates which are only slightly more than those paid by the Treasury, which is preventing private actors from holding fixed rate mortgages.²³² Excessive subsidies or other privileges will crowd out private actors from the market, leaving a public monopoly. In this scenario, any advantages of public-private competition will be gone.

The purpose of the state-owned enterprise is to serve as benchmark for private competitors—not to dominate a market. After all, the emergence of private competitors is the goal of all deregulation and liberalisation. The accountability of the state-owned enterprise to the government must be secured by using the traditional instruments provided by administrative law. In addition, the application of antitrust laws may help to protect private competitors from abusive behavior of dominant state-owned enterprises. No accountability exists if the government does not use its instruments of regulatory oversight to control its enterprise.²³³ Some public-related enterprises even deny the government's regulatory power.²³⁴

²³⁰ Debating unbundling of the local loop, the fear to lose earnings of CHF 2.5 billion annually, to weaken the traditional public provider, to render investments in infrastructure unprofitable, and to lose jobs induced the Swiss Parliament to limit unbundling to the old-fashioned copper cable and to keep a factual monopoly on the fiber optic cable. See Official Bulletin of the Parliament 2004, 1693-1702 (Oct. 7, 2004) (statements of Reps. Levrat, Marti, Hollenstein, and Aeschbacher).

²³¹ Conforming mortgages, i.e. loans with an original principal amount no greater than \$417,000 (since 2006), are eligible for purchase by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation; to mention also the Federal Home Loan Bank ("FHLB") system, which is providing short-term loans. In May 2001, the Congressional Budget Office estimated the value of federal subsidies for these institutions at \$13.6 billion, including an \$8.8 billion subsidy to general obligation debt securities. Of the total subsidy, only \$7.0 billion are passed through mortgage borrowers; Fannie Mae, Freddie Mac and the FHLBs retain nearly half of the total subsidy. See *Federal Subsidies and the Housing GSEs*, Cong. Budget Off. Study, 107th Cong. 15-22, 25-28 (May 2001) (available at <http://www.cbo.gov/ftpdocs/28xx/doc2841/GSEs.pdf>).

²³² See Stanton & Moe, *supra* n. 177, at 83.

²³³ See Richard Munson, *Restructure TVA: Why the Tennessee Valley Authority Must be Reformed* ¶ 3, http://www.nemw.org/ertva_reform.htm (accessed Feb. 24, 2007) (TVA is run by a board of three individuals appointed to staggered nine-year terms by the President; their decisions are not subject to review by state regulators or federal agencies). SLM Corporation, commonly known as Sallie Mae, was created by Congress as a government-sponsored enterprise and had no regulator until it was fully privatized by the end of 2004. See 20 U.S.C. § 1087 (1965) for regulatory provisions concerning Sallie Mae.

²³⁴ The U.S. Department of Housing and Urban Development ("HUD") claims, based on the National Housing Act, oversight responsibility regarding Fannie Mae and Freddie Mac, but its actual powers are

C. Postal Monopoly, Control of Market Entry and Production

Regulatory provisions bar private postal providers in the U.S., Germany, and Switzerland from offering a full range of postal services. The postal monopoly is most extensive in the U.S., where it includes the handling of all letters and the use of mailboxes. In Europe, the monopoly is limited to letters of a certain weight (50 grams in Germany, 100 grams in Switzerland). The U.S. has not monopolized parcel services and the EC opened parcel services for competition in 1998. The profits derived from the letter monopolies have the purpose of providing funding for universal service. The postal monopoly shows the usual effects. The monopolist reduces output and charges excessive prices. The consumers have to bear these effects, which contradict the goals of broad provision and affordable prices of essential services. The deviation from market outcome creates the usual deadweight loss because of the monopoly's allocative inefficiency.

Some scholars argue that the monopolist may realize economies of scale, thereby improving its productive efficiency.²³⁵ In the past, however, the lack of any stimuli for innovative or efficient performance seems to have decreased the efficiency of public postal providers.²³⁶ As early as 1945, the Supreme Court pointed out that "possession of unchallenged economic power deadens initiative, discourages thrift and depresses energy; ... immunity from competition is a narcotic, and rivalry is a stimulant, to industrial progress."²³⁷ As the previous section has shown, the monopoly may also induce strategic behavior, and the state-owned enterprise may try to leverage its monopoly power in other markets. The limited range of products offered by private enterprises reduces their ability to operate efficiently and the monopoly denies such enterprises from realizing possible economies of scope and economies of scale.²³⁸

Except for its monopoly on letters and letterboxes, the U.S. has not enacted further regulatory safeguards in postal service. Germany and Switzerland control entry in postal markets by requiring a license. Applicants may not be denied the license if they fulfill the requirements and they do not have to prove that their entry is *desirable*.²³⁹ As outlined above, licensees are subject to production controls and have to meet certain standards regarding quality, availability, and performance. In order to assess an applicant's ability to fulfill these standards, the authority verifies

unclear. 12 U.S.C. § 1701 (1934). Fannie Mae denies that HUD has the power to issue regulations on Fannie Mae's conduct of business. See Froomkin, *supra* n. 52, at 614.

²³⁵ See Oliver E. Williamson, *Economics as an Antitrust Defense: The Welfare Tradeoffs*, 58 Am. Econ. Rev. 18, 21-22 (1968) (arguing that the gain in productive efficiency of a monopoly may outweigh the loss in allocative efficiency).

²³⁶ Cf. William S. Comanor & Harvey Leibenstein, *Allocative Efficiency, X-Efficiency and the Measurement of Welfare Losses*, in *The Collected Essays of Harvey Leibenstein Vol. 2: X-Efficiency and Micro-Micro-Theory* 27, 27-32 (Kenneth Button ed., Edward Elgar Publ. Ltd. 1989).

²³⁷ *U.S. v. Aluminum Co. of Am.*, 148 F.2d 416, 427 (2d Cir. 1945).

²³⁸ See David E. M. Sappington & Gregory J. Sidak, *Anticompetitive Behavior of Enterprises*, in *Competing with the Government: Anticompetitive Behavior and Public Enterprises* 1, 12-14 (Richard R. Geddes ed., Hoover Instn. Press 2004).

²³⁹ See *supra* pt. II(D).

the applicant's expedience of its business organization, know-how on key positions, personnel planning, logistics, facilities, and partner organizations. The authority verifies whether assets and revenues are sufficient to cover the expected obligations, and whether the applicant intends to implement an adequate quality management system.²⁴⁰ It is difficult to imagine the reasons that would justify such ex-ante controls. Legislators may believe that customers are unable to judge the quality of service in advance. Such asymmetric information would provide an economic rationale for the licensing requirements. However, the present regulatory framework in the U.S., Germany, and Switzerland is mainly concerned with the quality of service of the dominant (public) provider. Further, customers of postal services would hardly suffer irreparable damage from bad service, i.e. damage not covered by the liability of the fallible postal provider.

In addition, destructive competition and deterioration of quality does not seem to be a problem of postal services. Postal network capacity is unlikely to suffer from chronic excess capacity since it can be built in incremental steps and be adjusted rapidly.²⁴¹ It is difficult to assess the effects of the described entry controls in terms of customer protection and deterrence from market entry. By December 31, 2004, 1,746 postal enterprises obtained a license in Germany, of which 551 have already left the market again.²⁴² The fact that such a large amount of enterprises has exited the market indicates that the German license requirements did not provide much help in preventing incompetent firms from entering the market.

By August 15, 2006, only 23 applicants had obtained licenses for parcel services in Switzerland, of which 8 are also authorized to carry mail. The license requirements probably did not deter entry on a small scale since small enterprises with a turnover of less than CHF 100,000 do not need a license. The authority had registered 24 of such small enterprises by December 6, 2006. This relief for small enterprises reveals that the need for consumer protection in the postal market is, in fact, very low. Indeed, Switzerland makes no distinction based on turnover in licenses for doctors or airlines. An applicant for a license has to show that it meets the basic common working standards in the licensed sector; this requirement prevents social dumping in postal markets.²⁴³

²⁴⁰ See Die Bundesnetzagentur [German Federal Network Agency], *Hinweise zur Beantragung von Lizenzen zur Beförderung von Briefsendungen* [Application Procedure for Letter Post Licenses], http://www.bundesnetzagentur.de/enid/04bc5e0b211496fa200072fb678cfd0b,0/Lizenzen/Hinweise_zur_Lizenzbeantragung_7a.html (accessed Feb. 24, 2007); see also Eidgenössisches Department für Umwelt, Verkehr, Energie und Kommunikation & Postregulationsbehörde, [Swiss Federal Department of Environment, Transport, Energy and Communications & Postal Regulation Authority], *Die Bereitstellung der logistischen Mittel, die fachlichen Fähigkeiten und die Leistungsfähigkeit* [Logistics, Know-how and Service Capability] 2-3, <http://www.postreg.admin.ch/imperia/md/content/postreg/dokumentationen/4.pdf> (Nov. 26, 2003).

²⁴¹ See Kahn, *supra* n. 53, at 173-186.

²⁴² See *Regulating Authority for Telecommunications and Post*, *supra* n. 170, at 55.

²⁴³ See Eidgenössisches Department für Umwelt, Verkehr, Energie und Kommunikation & Postregulationsbehörde [Federal Department of Environment, Transport, Energy and Communications

With a dominant public provider present, however, common working standards are probably identical with the working standards of the state-owned enterprise. Indeed, the Swiss regulatory authority mentions the standard labor agreement of the public provider as a reference for common working standards.²⁴⁴ There is no reason why a postal service employee should enjoy a privileged, protected employment considering that hardly any social dumping was ever reported in postal markets. Therefore, such ex-ante control cannot be justified.²⁴⁵ Instead, lobbying for uniform working standards seems to be an easier way for the state-owned enterprise to raise rivals' costs.²⁴⁶

The state-owned enterprise, as provider of the reference working standards, does not have to change its employment contracts. Instead of prescribing working standards, governments could rely on the benchmark provided by the state-owned enterprise. By offering improved working standards, the state-owned enterprise induces private actors to offer better working standards than comparable branches of industry. Private actors are in danger of losing their most capable employees to the government if they are not able to offer at least the same benefits. Of course, this also works vice versa.

Thus, there is lack of evidence whether private working standards are really worse than standards of state-owned enterprises. However, even if private working standards are worse, it is dubious whether state-imposed, privileged working standards for one branch of industry are actually desirable. Prescribing minimum working standards obstructs competition for employees, and does not trigger the positive effects of mutual benchmarking by public-private competition. Extending this conclusion to all elements of postal service, there is no need to promote public goals by additional regulatory safeguards. The benchmark of the state-owned enterprise is sufficient.

& Postal Regulation Authority], *Einhaltung der branchenüblichen Arbeitsbedingungen als Konzessionsvoraussetzung* [Meeting Common Working Conditions as Requirement for Licenses] 1 (2003, amended 2007) (available at <http://www.postreg.admin.ch/imperia/md/content/postreg/dokumentationen/120.pdf>).

²⁴⁴ *Id.* at 2 (the overall labor agreement of the Swiss Postal Service for 2005 includes minimum monthly wages of CHF 3,100, fringe benefits like allowances for children, extended maternity leave, extended vacations of at least 5 weeks, etc.).

²⁴⁵ In fact, most private providers offer better working conditions than required. See *Activity Report 2004*, *supra* n. 168, at 20. Common working conditions have to be met also in telecommunication services. With an incumbent public provider present, the situation is comparable to the postal market. Only the public enterprise has concluded an overall labor agreement with its employees. There is no evidence on social dumping. See Bundesamt für Kommunikation [Federal Office of Communications], *Faktenblatt zur Vollzugspraxis betreffend der branchenüblichen Arbeitsbedingungen im Telekommunikationssektor* [Fact Sheet on Working Conditions] 6, <http://www.bakom.admin.ch/dokumentation/zahlen/00545/00722/00926/index.html?lang=de> (Jun. 2005). Nevertheless, the requirement on working conditions was tightened. Now, all telecommunication providers will have to employ a certain quota of trainees. At least, attempts to extend the standard labor agreement of the state-owned enterprise or to force all providers to conclude collective bargaining agreements failed. See Official Bulletin of the Parliament 2004, 1683-1685 (Oct. 7, 2004) (statements of Reps. Levrat, Germanier, Daguët, Brun, Teuscher).

²⁴⁶ *Cf. United Mine Workers v. Pennington*, 381 U.S. 657 (1965).

When opening services of general interest for competition, the EC has increased the amount of economic regulation.²⁴⁷ The use of regulatory safeguards and public enterprise, however, is too cautious to realize a large amount of efficiency gains. As discussed above, the mentioned safeguards are probably useless to prevent incapable firms from entry, and therefore, useless to protect customers from incapable companies. We also have to keep in mind that the current regulation imposes no universal service obligations on private licensees; it seems that the license requirement merely serves statistical purposes.²⁴⁸ The current policy goals for private postal providers hardly justify the described loss of efficiency, the distortion of public-private competition, and the costs of regulation (licensing procedure, compliance, enforcement costs).²⁴⁹ Since the postal network consists merely of premises and postal roads, neither a sector-specific competition law nor additional regulation are needed. However, such sector-specific regulation may be necessary in other essential services like telecommunications (for interconnection) and electricity (for third party access).²⁵⁰

D. Uniform Pricing, Rural Service, and the Need for Subsidies

Private postal service providers in the U.S., Germany, and Switzerland are not subject to the regulatory instrument of price controls, which probably have the most distorting effect on competition. As an exception to this general rule, regulators have to approve the prices of the dominant postal provider in Germany and the state-owned enterprises in the U.S. and Switzerland. These providers have to apply uniform pricing throughout the country. In addition, they are required to provide effective postal services to residents of both urban and rural communities. As the previous section has shown,²⁵¹ many countries proclaim that the nationwide provision of postal and other essential services and uniform pricing are a policy goal of overwhelming importance. In Switzerland, pricing based on uniform principles even enjoys constitutional protection.²⁵² It is clear under 39 U.S.C. § 101(b), that postal services shall be provided in rural areas, communities, and small towns, where post offices are not self-sustaining.

The legislature's underlying assumption is that rural post offices are not generating a profit, and rural service operates at a loss. Thus, it seems

²⁴⁷ Cf. Lester M. Salamon, *Economic Regulation*, in *The Tools of Government*, *supra* n. 29, at 124-25.

²⁴⁸ See *Regulating Authority for Telecommunications and Post*, *supra* n. 170, at 60 (arguing that yearly report duties have the purpose to compile the authority's yearly report to the Parliament).

²⁴⁹ See Lester M. Salamon, *The Governance and the Tools of Public Action: An Introduction*, in *The Tools of Government*, *supra* n. 29, at 121, 145 (arguing that governments will prefer regulation since it is mostly invisible to the taxpayer, since a regulatory agency consumes only a small part of the budget; the costs of regulation borne by the affected industries is estimated to amount to billions annually).

²⁵⁰ With the possible exception of access to P.O. boxes. See also Michel Kerf & Damien Geradin, *Controlling Market Power in Telecommunications: Antitrust vs. Sector-Specific Regulation*, 14 *Berkeley Tech. L.J.* 919, 1017-20 (1999) (arguing that New Zealand, with its dominant incumbent provider, its lack of specific pro-competition rules, and its absence of a specialized regulator, is the country with the strongest need for structural reforms in telecommunications, compared to Australia and the U.S.).

²⁵¹ See *supra* pt. III.

²⁵² BV (Bundesverfassung) 92.

obvious that the economies of scale are different in urban and rural postal premises. It is uncertain whether an unrestrained private company would bear the costs of rural post offices or whether an efficient provider could make rural facilities profitable. Experiments of incumbent providers with new forms of rural postal service show that a limitation of losses from rural service is possible.²⁵³ As an economic rationale, a postal provider will refrain from closing unprofitable rural premises if sufficient benefits can be derived from operating a nationwide network of access points. A nationwide network may realize such benefits if parts of the revenues generated elsewhere are attributable to rural facilities (e.g. mailings to rural areas)²⁵⁴ or if economic benefits accrue to profitable urban post offices from running rural facilities.²⁵⁵ The large service networks of UPS and FedEx strongly suggest that private companies will not abandon rural service entirely, even if they are not subject to universal service obligations. In any case, it is expected that private companies would satisfy demand for postal service in rural areas, even if for higher fees. However, subsidized rural service of public providers limits the expansion of private postal service networks in rural areas and competition between providers.

Uniform pricing and rural service in the U.S. and European countries are funded by using monopoly profits and cross-subsidizing low-profit, rural markets with revenues from high-profit, urban markets. Monopoly profits will melt away as soon as legislatures abolish the postal monopoly and competitive pressure forces prices to decline. Competitors of the incumbent provider will expand their service network as long as they can cover their marginal costs. They may expect no profits in rural areas because the public provider offers service below costs there. Thus, new market entrants will concentrate their services in densely populated, urban areas and few providers will provide traditional postal services in rural areas (except probably for value-added services like courier mail).

If the partial postal monopoly remains in place, we may expect an even more limited service network from private firms. Limiting entry to lucrative markets, while neglecting low-profit markets, is generally called *cream-skimming*, which has a very negative connotation; cream-skimming is caused, however, by regulation, and not by greedy, profit-maximizing private companies.²⁵⁶ Still, cream-skimming erodes prices in urban areas and makes it difficult for the state-owned enterprise to cross-subsidize service provisions in rural areas with revenues in urban areas. Inevitably, cream-skimming will undermine the postal service's uniform pricing system.

²⁵³ The Swiss Postal Service replaces unprofitable post offices by home-delivery-services, by mobile post offices, by branches, and by franchises (e.g. by joint ventures with local shopkeepers or by independent entrepreneurs).

²⁵⁴ See Note, *The Postal Reorganization Act: A Case Study of Regulated Industry Reform*, 58 Va. L. Rev. 1030, 1085 (1972) [hereinafter *Case Study*].

²⁵⁵ See Kahn, *supra* n. 53, at 190 n. 54 (arguing that making telephone services and electricity available on the farm benefits city dwellers because it holds down urban congestion).

²⁵⁶ *Id.* at 7-10, 220-46 (citing examples of alleged cream skimming).

There are difficulties in identifying the rationale behind the uniform pricing system and the cross-subsidy. Uniform pricing, applying the same pricing scheme throughout the country, may be one way to realize *fair and equitable, non-discriminatory* prices. Economists would argue that a uniform pricing scheme does not take into account that different types of consumers cause different costs. In their perspective, uniform pricing causes discrimination of one customer group (urban dwellers) in favor of another group (rural dwellers). Such discrimination is hardly justifiable—the sacrifices imposed on one group generally exceed the benefits of the subsidized group; thus, cross-subsidization is inconsistent with both profit and welfare maximization.²⁵⁷ Economists will take the existence of a *cream* to *skim* as signal that prices are excessively high; they will welcome competition as instrument to erode these super-competitive prices.²⁵⁸

It seems dubious whether uniform postal pricing causes a positive externality, that is, whether the uniform service and pricing scheme has social benefits not reflected in postal rates. It is sometimes stated that uniform prices will prevent migration into overcrowded cities or help to slow the decline of rural areas. Postal service is also regarded as a prerequisite for economic development and sustained growth. It is rarely thought that the cross-subsidy is funded by excessive prices in urban areas.²⁵⁹ Today, rural areas are, in fact, wealthier than city centers. A recent U.S. Census Bureau population report on poverty shows a poverty rate of 17.5% inside central cities in 2003 (12.1% if the richer suburbs are included), while poverty outside metropolitan areas amounts to 14.2%; in absolute numbers, poverty in metropolitan areas (28.367 million) exceeds poverty outside metropolitan areas by four times (7.495 million).²⁶⁰ Thus, it may be true that a wealthy employee of an investment bank, who lives in a city suburb, cross-subsidizes the postage of a relatively poor farmer; however, it is also true that widows and orphans living in central cities cross-subsidize the postage of tourists, who send postcards from fancy (rural) ski resorts.²⁶¹

The cross-subsidy rationale is even more questionable if we

²⁵⁷ See Alfred Haid, *The Chicago School of Regulation Theory*, in *Approaches and Dilemmas in Economic Regulation: Politics, Economics, and Dynamics* 74, 82-83 (Atle Midttun & Eirik Svindland ed., Palgrave Macmillan 2001).

²⁵⁸ *Id.* at 221, 243. A case for non-justifiable cream skimming may be if the public enterprise would provide reserve or back-up capacity, which is not given in the situation at hand. *Id.* at 236.

²⁵⁹ See *Case Study*, *supra* n. 254, at 1086 (arguing that the impact on any location decision must be de minimis); Lester M. Salamon, *The Governance and the Tools of Public Action: An Introduction*, in *The Tools of Government*, *supra* n. 29, at 141 (arguing that the service subsidy system does very little in inducing more people to attach themselves to utilities and that not necessarily the poor people are subsidized); Kahn, *supra* n. 53, at 190.

²⁶⁰ See Carmen DeNavas-Walt et al., *Income, Poverty, and Health Insurance Coverage in the United States: 2003* at 9-12 (U.S. Census Bureau 2004) (available at <http://www.census.gov/prod/2004pubs/p60-226.pdf>). In Germany, the poverty rate is increasing in small rural communities, while urban poverty is still higher in absolute numbers. See Statistisches Bundesamt [Federal Statistical Office of Germany], *Datenreport 2004 [Report on Statistical Data 2004]*, 631-34 (available at <http://www.bpb.de/files/8R25DJ.pdf>).

²⁶¹ Cf. Lester M. Salamon, *The Governance and the Tools of Public Action: An Introduction*, in *The Tools of Government*, *supra* n. 29, at 140-44.

consider that business customers generate the largest part of postal service revenues (in Germany 84% of letter volume not including direct mail, in Switzerland 85% of revenue).²⁶² Thus, corporations—not poor rural dwellers—are affected most by the cross-subsidy. Summarizing, the rationale behind uniform pricing is based on prima facie equity and fairness considerations, which probably would not withstand a thorough analysis.

Lawmakers have also expressed their hope that uniform postal service (i.e. uniform pricing and nationwide service) could bind the Nation together.²⁶³ Costs and benefits related with this factor, however, have not yet been assessed. Even if uniform pricing resulted in some net benefit for rural dwellers or rural communities (justifying the redistribution rationale), the distortions of competition in postal markets would hardly be justifiable. Direct subsidization of rural communities or tax expenditures²⁶⁴ for companies are probably more effective and efficient in attracting business to rural areas than a cheaper postage; these instruments also cause less distortions.²⁶⁵

Without the postal monopoly as a source for funding, the uniform pricing scheme needs some kind of subsidy to be sustainable. Direct subsidies or the accumulation of debts by the state-owned enterprise would both be less damaging to competition than the present regulatory framework.²⁶⁶ As I argued above, however, competitive pressure by private actors will not induce more efficient operations of the state-owned enterprise if there is no threat of bankruptcy or replacement. The continuous flow of subsidies to the state-owned enterprise may take away this threat of replacement; even if private market participants provide a benchmark for performance, the state-owned enterprise might ignore it. Besides causing waste, subsidies may induce a state-owned enterprise to invest in anticompetitive strategies. Further, subsidies tend to divert money from other governmental services like education and health. Generally, deficits of state-owned enterprises may undermine fiscal stability by contributing to inflation or by consuming credit that would otherwise go to the private sector.²⁶⁷ Public-private competition works best if subsidies and other privileges (like borrowing near treasury rates because of government

²⁶² See Deutsche Post World Net, *Annual Report 2005* at 52, http://investors.dpwn.com/en/investoren/publikationen/berichte/2005/geschaeftsbericht/dpwn_annual_report_2005_en.pdf (accessed Feb. 23, 2007); Swiss Post, *Berichterstattung 2004* [*Annual Report 2004*] 32, http://www.post.ch/de/uk_bmk05_geschaeftsbericht04.pdf (accessed Feb. 24, 2007).

²⁶³ 39 U.S.C. § 101; see also Alan L. Sorkin, *The Economics of the Postal System* 42-45 (Lexington Books 1980) (arguing that it is difficult to determine the level of external benefits arising from the postal system).

²⁶⁴ Although a popular instrument, tax expenditures—in particular tax incentives for businesses—have proven to be of moderate effectiveness. Studies have repeatedly shown that such incentives have little impact on firms' location and investment decisions. See Christopher Howard, *Tax Expenditures*, in *The Tools of Government*, *supra* n. 29, at 410, 433; see generally Robert G. Lynch, *Do State & Local Tax Incentives Work?* (Econ. Policy Inst. 1996).

²⁶⁵ See Kahn, *supra* n. 53, at 190-91 (taking internal subsidization of rural electricity consumers as example to outline the faced efficiency losses).

²⁶⁶ *Id.* at 240.

²⁶⁷ See World Bank Group, *supra* n. 134, at 46-47.

guarantees, tax and other regulatory exemptions) are avoided.²⁶⁸

Nevertheless, the EC and Switzerland have readily implemented rules regarding the grant of subsidies. EC law allows special compensation of the universal service provider facing an unfair financial burden, as well as direct subsidies.²⁶⁹ Both Germany and Switzerland have established a fund for the compensation of the universal service provider; the competitors of the universal service provider will have to nourish these funds with annual license fees.²⁷⁰ The amount of the fee is based on the licensee's share of the total turnover achieved in the licensed sector; its economic effects are similar to a sector-specific value-added tax. We have to recall that now, the (small) private market participants merely act as price takers; they cannot shift the fee directly to their customers because they have no possibility to charge a higher price than the state-owned enterprise. The fee, consequently, artificially decreases the output of competing postal providers, while it increases artificially the output of the universal service provider.²⁷¹ Problems in calculating the fee may even increase its destructive effect on competitors. The regulator may have difficulties in properly assessing the long-term additional costs of providing an efficient universal service, the adequate interest on the capital employed, and the income derived from universal service.

Indeed, the Swiss regulatory body, in its first year of operation, has found that the universal service provider reported considerably lower earnings than effectively retained in 2004.²⁷² We can imagine the challenge to identify unprofitable investments in universal service, only carried out with the intention to raise rivals' costs. If the postal service manages to show exaggerated costs for universal service in its books, the subsidy for rural service turns into a disguised and undesirable subsidy to the postal service as a whole.²⁷³ Switzerland exempts private providers from the fee if they provide postal services throughout the country, and if they apply uniform prices regardless of delivery distance.²⁷⁴ In other words, a private actor asking for the exemption has to offer the same services as the

²⁶⁸ See Froomkin, *supra* n. 52, at 582-83; World Bank Group, *supra* n. 134, at 36, 81-86; *supra* pts. III(D)-(F).

²⁶⁹ *Treaty Establishing the European Community*, Dec. 24, 2002, O.J. (C 325) 35, art. 87-88 (2002) [hereinafter *EC Treaty*] (subsidies, distorting competition and affecting trade between member states, may be declared compatible with the common market if they aid to promote economic development of areas where the standard of living is abnormally low, if they aid to promote the execution of an important project, or if they aid, e.g., to facilitate the development of certain economic activities or of certain economic areas).

²⁷⁰ The fees are designed as consideration for the license to make use of the governmental postal monopoly, as laid down in article 73 of the German Constitution and article 92 of the Swiss Constitution. GG (Grundgesetz) 73; BV (Bundesverfassung) 92.

²⁷¹ A better (less distorting regarding output) way of funding the subsidy with contributions of competitors, if any, would probably be to base the consideration on profits, instead of turnover.

²⁷² See *Activity Report 2004*, *supra* n. 168, at 14-16 (arguing that earnings retained from universal service amount to CHF 776 million, and not to CHF 522 million as displayed in the books (+49%)).

²⁷³ See *Case Study*, *supra* n. 254, at 1086 (arguing that in such a case, prices would be set below their social cost of production, with resultant distortion of resource allocation between postal service and other goods).

²⁷⁴ See *Annual Report of Swiss Post*, *supra* n.172.

universal service provider, but without protective monopoly and without subsidy—it would be a surprise if a provider ever qualifies for the exemption.

Governments may grant subsidies for universal (rural) service in ways that are more efficient and less distortive. It does not make much sense if the EC or the Swiss Federal Government prescribe the desired postal service level in detail, regardless of local needs.²⁷⁵ In public transport, Germany and Switzerland have implemented a regulatory framework that requires municipalities and states to order the desired transport services from a transport company. All transport companies may tender transport services. By ordering the service, states and communities participate in the determination and funding of the desired level of public transport; they have, consequently, at least some incentives to limit public transport to the socially desired level.²⁷⁶

This subsidy scheme may also be applied to postal services. Instead of subsidizing the universal service provider, the federal government could support rural municipalities in funding local postal service. The affected communities are then better able to decide how to spend the subsidy for postal services. For example, they may choose to provide for one letter delivery per working day, to subsidize postage, increase the density of mailboxes or to extend the business hours of post offices. Support in form of a general-purpose assistance would allow the affected municipalities to shift funds to other essential services such as roads or telecommunications.²⁷⁷

Municipalities eligible for a subsidy could take bids from all postal service providers, giving local governments the possibility to contract with the most suited enterprise.²⁷⁸ Contracting in rural areas will strengthen

²⁷⁵ The determination of the desired universal service on a local level seems also to be more consistent with the principle of subsidiarity as laid down in article 5(2) of the *Treaty Establishing the European Community*, and article 5(a) of the Swiss Constitution. See *EC Treaty*, *supra* n. 269, at art. 5(2); BV (Bundesverfassung) 5(a).

²⁷⁶ *Eisenbahngesetz* [Swiss Railroad Act], SR 742.101, art. 49-54; see also *Allgemeines Eisenbahngesetz* [German General Railroad Act], v. 27.12.1993 (BGB1 I S. 2378, 2396, § 15); Commission Regulation 1191/69 on Action by Member States Concerning the Obligations Inherent in the Concept of a Public Service in Transport by Rail, Road and Inland Waterway, 1969 O.J. (L 156) 1-7.

²⁷⁷ Instead of general-purpose assistance (which has no restrictions on the use of funds), subsidies may also be granted in the form of categorical grants (which must be used for a quite narrow purpose like postal service) or block grants (which provide assistance for broader defined functions like rural development). See David R. Beam & Timothy J. Conlan, *Grants*, in *The Tools of Government*, *supra* n. 29, at 340, 343-44. An analysis of U.S. federal grants shows a growing reliance on narrow-purpose categorical aids while general-purpose spending has basically disappeared. *Id.* at 351-52. Categorical grants sometimes create perverse incentives for overinvestment or waste, *Id.* at 364-70, and should only be carried out when local governments make substantial contributions to projects; in its reformed program for revenue equalization, Switzerland tries assistance to general-purpose grants. See *Botschaft zur Neugestaltung des Finanzausgleichs und der Aufgaben zwischen Bund und Kantonen* [Message to the Reorganization of the Financial Adjustment and the Tasks between Federation and Cantons], 2367-69, <http://www.admin.ch/ch/d/ff/2002/2291.pdf> (Nov. 14, 2001).

²⁷⁸ Cf. Gómez-Ibáñez, *supra* n. 105, at 188-216 (arguing that contracts may be used to provide tailor-made services, while regulation is usually limited to standardized service options; in air transport, contracts proved to be useful when local companies and governments tried to induce airlines to add direct flights on small airports). This corresponds also with the proposal of David E. Sappington &

public-private competition and improve the benchmarking process. Taking bids from all postal providers will allow local governments to assess the costs of universal postal service through a competitive process. Such assessment is not possible if a monopolist provides postal services at regulated prices. Competition for service contracts in rural areas will force the state-owned enterprise to keep up with its rivals not only in urban areas, but also in rural areas.

Summarizing, regulatory safeguards (with potentially heavy financial burdens) restrain private postal service providers in Germany and Switzerland, while providing competitive advantages to the universal service provider. We may ask why the U.S., Germany, and Switzerland have chosen to implement an obviously inefficient regulatory framework. One important reason may be that the implemented framework moves the costs of universal service from the governmental budgets. The costs of the postal monopoly, the fee schedule, and the license requirements are largely invisible for the public, who bears the costs for universal service in the form of excessive prices and deadweight loss.²⁷⁹ The current framework bars providers from implementing more efficient and more consumer-oriented postal services. Governments could grant subsidies more efficiently, in the form of general-purpose assistance to rural municipalities, making it possible for all postal providers to bid for service contracts. Finally, contracting will move the cost of universal service on the governmental budget.²⁸⁰

E. Role of Regulators

Governments justify regulators with the need to promote public interest, in particular in *merit good* markets. However, there are always suspicions that special interests—rather than public interest—will capture regulators.²⁸¹ Regulators may try to protect state-owned enterprises from competition, (e.g. by extending minimum service requirements).²⁸² As

Joseph E. Stiglitz in *Privatization, Information and Incentives* to auction contracts, which entitle private firms to receive a subsidy for the adjustment of their output to a socially desired level. David E. Sappington & Joseph E. Stiglitz, *Privatization, Information and Incentives*, 6 J. of Policy Analysis and Mgt., 523, 567-82 (1987). However, such contracts will be incomplete. See Klaus M. Schmidt, *The Costs and Benefits of Privatization: An Incomplete Contracts Approach*, 12 J.L. Econ. & Org. 1, 2-4 (1996) (arguing that while privatization provides incentives to save costs (higher productive efficiency) it may result in a less efficient productive level (lower allocative efficiency)). As outlined above, the presence of a public enterprise will reduce the effects of this incompleteness.

²⁷⁹ See Lester M. Salamon, *The Governance and the Tools of Public Action: An Introduction*, in *The Tools of Government*, *supra* n. 29, at 35-36 (arguing that invisibility is a tremendous political asset and that invisible tools, such as regulation, are easiest to pass); May, *supra* n. 154, at 159-60.

²⁸⁰ See Steven J. Kelman, *Contracting*, in *The Tools of Government*, *supra* n. 29, at 284-85.

²⁸¹ See Gómez-Ibáñez, *supra* n. 105, at 39-47, 343-44 (particularly, this may be true in countries with no tradition of independent regulatory institutions); see Kahn, *supra* n. 53, at 11-14; but see Reiter, *supra* n. 182, at 335-39.

²⁸² This is not necessarily true, looking at the numerous attempts of the (independent) Swiss Federal Telecommunication Commission to strengthen competition on the local loop. See *Commcare AG v. Swisscom AG, ComCom* (October 2, 2000), rev'd, Federal Supreme Court 2A.503/2000 (Oct. 3, 2001); *TDC Switzerland AG v. Swisscom AG, ComCom* (Feb. 5, 2002) (denying unbundling of local loop because of obiter dicta of the Federal Supreme Court in 2A.503/2000 (October 3, 2001); *TDC Switzerland AG v. Swisscom Fixnet AG, ComCom* (Feb. 19, 2004), rev'd, Federal Supreme Court

outlined above, public-private competition will supersede the need for sector-specific regulation, and consequently, the need for regulators. In postal services, application of the antitrust laws should be sufficient to protect the competitive process. Antitrust authorities could probably deal with competitive concerns in postal markets, such as access to post office boxes of dominant providers (which may be an essential facility).²⁸³

F. Assumption of a Non-Benevolent Government

The public choice theory claims that politicians and civil servants will maximize their votes or their budgets respectively. They are not guided by public interest or any ethical or moral rules, and they would capture rents and profits directly, if only they could. The theory applies a strict concept of *homo oeconomicus*,²⁸⁴ with actors being rational and self-interested individuals. The theory predicts that politicians will falsely invoke public goals to promote the special interests of selected groups.²⁸⁵ Laws protecting civil service, designed to insulate bureaucrats from such political pressures, will also insulate them from the citizens and will allow them to pursue their own interests.²⁸⁶

In essential services, governments will be tempted to yield to popular pressures to regulate private actors or renege on other promises to private companies.²⁸⁷ For example, this could be done in order to lower previously negotiated tariffs or to prevent lay-offs. Many investments in essential services are sunk costs and private actors cannot retaliate upon governments by withdrawing their investment.²⁸⁸ A state-owned enterprise, vested with closer connections to the government than the rest of the industry, will lobby for limits on competition or even try to capture rulemaking processes to benefit its own interests.²⁸⁹ Restraining private

2A.178/2004 (November 30, 2004); *TDC Switzerland AG v. Swisscom AG and MCI WorldCom AG v. Swisscom AG*, *ComCom* (Nov. 6, 2003), rev'd, Federal Supreme Court 2A.586/2003 and 2A.587/2003 (October 1, 2004), remanded to *ComCom* (June 6, 2005), aff'd, Federal Supreme Court, BGE 132 II 284 (all decisions available at <http://www.bger.ch> and <http://www.comcom.admin.ch/themen/00500/index.html?lang=en>).

²⁸³ *Postgesetz [German Postal Act]*, v. 22.12.1997 (BGBI I S. 3294, § 29) (not regulated in Swiss law).

²⁸⁴ Although the application of a strict concept of *homo oeconomicus* is probably not always appropriate and fails in some core public choice theorems, people go to vote although their costs to vote outweigh the benefits derived from voting; they invest in information before voting. Bureaucrats in office do not seek only their private benefit (or else, government would hardly work). Deregulation took place in industries although limiting the power of bureaucrats and excessive profits of the industry. See James M. Buchanan, *Public Choice and its Critics*, in *The Collected Works of James M. Buchanan: Politics as Public Choice* vol. 13, 112, 118-21 (Liberty Fund, Inc. 2001).

²⁸⁵ See generally Haid, *supra* n. 257, at 74-88; Cf. Hodge, *supra* n. 3, at 36-38.

²⁸⁶ See e.g. Lester M. Salamon, *The Governance and the Tools of Public Action: An Introduction*, in *The Tools of Government*, *supra* n. 29, at 12.

²⁸⁷ When choosing instruments, command-and-control regulation will relieve the government from negotiating an explicit contract and will move costs off-budget; see José A. Gómez-Ibáñez, *supra* n. 105, at 2-3, 12-13. However, the prospect of regulatory action may reduce investment of incumbent providers and deter entry of potential competitors. Since regulatory provisions form an entry barrier, even incumbent private providers after making investments to comply with regulation may lobby for regulation as an instrument to dampen competition. See Haid, *supra* n. 257, at 75-76.

²⁸⁸ See Gómez-Ibáñez, *supra* n. 105, at 2-3.

²⁸⁹ See May, *supra* n. 154, at 172 (numerous actors involved in the regulation making process may render efforts to lobby for beneficial regulation difficult).

companies in the market is tempting because such restrictions enable the state-owned enterprise to inflate the value of the firm, keep an oversized workforce, or to make investments based on political—not business—reasons.

The positive effects of public-private competition, as described above, are perverted if a government tries to protect its enterprise from competitors. Instead of using the state-owned enterprise to replace regulatory safeguards, the government's enterprise will be the pretext to enact regulation. A government may also move its enterprise off-budget, allowing the state-owned enterprise to accumulate losses and weaken its incentives to increase efficiency. If state-owned enterprises are off-budget, governments may harvest the desired social benefits at once, while creditors (in case of bankruptcy²⁹⁰) or citizens have to bear the costs years later. Even bond markets are reluctant to limit the borrowing of state-owned enterprises by assessing its credit worthiness with general standards.²⁹¹

Summarizing, public choice scholars advise withdrawal of the state from an essential service provision, since politicians and civil service will always be tempted to abuse state-owned enterprises for their own inefficient purposes. As outlined above, the government's withdrawal from a direct service provision and enactment of regulatory safeguards instead, will not necessarily enhance social welfare. It needs a courageous government to withdraw all regulatory safeguards and to rely entirely on a state-owned enterprise as guardian for public goals. As discussed above, such a market configuration will trigger a mutual benchmarking process, inducing private companies to consider public goals to a certain extent, and inducing the state-owned enterprise to keep up in efficiency with its private competitors. The performance benchmark provided by private competitors, unrestrained by regulatory safeguards, will help the state-owned enterprise to resist undue political influences. This way, the market configuration will counteract moderate government failure,²⁹² while keeping some focus on *merit good* considerations. Since the market provides the benchmark, a regulator is not necessary. Nevertheless, no system of checks and balances is infallible; if politicians decide to drive out private competitors from postal markets, they have—history shows—plenty of possibilities to do so.

²⁹⁰ Although the law often lifts the government's liability for the debts of most governmental enterprises, markets generally assume that their debts carry an implicit guarantee from the treasury. See Froomkin, *supra* n. 52, at 555-59; Stanton & Moe, *supra* n. 177, at 83. According to the Energy Information Administration, the implicit treasury guarantee explains the AAA Standard & Poor's and Fitch Ratings for TVA, despite total financial obligations of \$25.9 billion at the end of Fiscal Year 2004. Energy Information Administration, *Federal Financial Interventions and Subsidies in Energy Markets 1999: Energy Transformation and End Use* 25, 29-31, [http://www.eia.doe.gov/oiaf/servicerpt/subsidy1/pdf/sroiaf\(2000\)02.pdf](http://www.eia.doe.gov/oiaf/servicerpt/subsidy1/pdf/sroiaf(2000)02.pdf) (May 2000).

²⁹¹ See Froomkin, *supra* n. 52, at 582-83.

²⁹² Cf. John G. Gullis & Philip R. Jones, *Public Choice: Outrageous Theory and Enraging Tests?* in *Public Choice Analysis of Economic Policy* 59, 82-84 (Alec K. Chrystal & Rupert Pennant-Rea eds., St. Martin's Press, Inc. 2000).

V. CONCLUSION

To pursue public goals in essential services, governments blend public and private sector characteristics; they provide their enterprises with more leeway to adopt market behavior and increase efficiency, and impose regulatory safeguards on private providers to secure policy goals. The combination of public enterprise and regulatory safeguards is inefficient; neither public sector nor private sector qualities may manifest themselves. State-owned enterprises in essential services have abused their discretion to exploit consumers and to squeeze competitors out of the market. Regulatory safeguards constrain competition by extending policy goals on private enterprises.

Many features of the current regulatory framework in postal markets rest on dubious grounds. The postal monopoly limits competition in major parts of the market, without proof that it is needed to fund universal service. In Germany and Switzerland, competitors may have to provide for additional funding of the universal service provider. If universal service needs funding, there are more efficient ways than subsidizing a monopoly provider. In Europe, the requirement to obtain a license imposes an additional burden on private postal providers, without being able to protect consumers from incapable enterprises. The U.S., Germany, and Switzerland favor a uniform pricing scheme for postal services, based on a dubious redistribution rationale.

This paper describes a concept of public-private competition, which leaves room for efficiency gains without losing focus on *merit good* considerations. The concept entertains the use of a state-owned enterprise as guardian of policy goals in postal markets. As a direct governance instrument of an administration, the state-owned enterprise overcomes problems of effectiveness, legitimacy, and political accountability. The concept leaves private actors unrestrained by regulatory safeguards. This way, a mutual benchmarking process is triggered. The state-owned enterprise, threatened by replacement, has to keep up with its private competitors in terms of efficiency; it may be better able to resist political pressures. Private actors, faced with the minimum service standard of the state-owned enterprise, are given incentives to consider policy goals in their business strategy. They will have to divert resources from shareholders to customers, but remain free to choose how to attract business. This mutual benchmarking will leave the competitive process largely intact. Competitors and consumers get their benchmarks in the market, superseding the need for regulators.