

**Issues Concerning Postal Services and Competition  
Policy Coinciding with the Enactment of the Law of the  
Privatization of the Postal Services**

—Countering Anticompetitive Acts Using the Monopoly Area—

(tentative translation version)

(References are only Japanese)

July 2006

Japan Fair Trade Commission

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## **Introduction**

### **Scope of Discussion**

The operation of Japan Post consists of postal business, postal savings business, and postal life insurance business. Upon privatization of the postal services, as the companies handling mail delivery, postal savings, and postal life insurance - Postal Service Company, Postal Savings Bank and Postal Insurance Company - will be established, respectively. In addition, the Post Office Company will be established to oversee about 25,000 post offices located throughout Japan. The three aforementioned companies will handle counter business. Furthermore, Japan Post Co., Ltd. will be established as a parent company of these four new companies. The same regulations controlling private competitors will be applied to these companies in stages. The Japan Fair Trade Commission highly appreciates that this is a major step forward in ensuring equal footing among service operators.

Since the idea of privatization is to grant the expansion of business areas to newly established companies, in accordance with the progress of privatization, it is critical to ensure equal footing among potential competitors. The basic policy of the privatization of the postal services (endorsed by the Cabinet on September 10, 2004) clearly states, “condition for fair competition with private companies should be ensured.” In addition, the Law of The Privatization of the Postal Services (promulgated on October 21, 2005) states, “measures should be taken to ensure fair competitive conditions for operators engaged in the same type of business.” The Japan Fair Trade Commission considers it its responsibility to review such issues from the viewpoint of Competition Policy.

Consideration of the expansion of business areas will start in accordance with the level of progress after postal privatization comes into effect in October 2007. As an exceptional case, however, it has decided to approve the new company for entering into the international logistic business<sup>1</sup> in April, 2006. As its first step, Japan Post was granted an approval on April 17, 2006, from the Minister of Internal Affairs and Communications for capitalizing on a cargo operator<sup>2</sup>, a joint venture with some companies including All Nippon Airways Co., Ltd.. Therefore, this report reviews the business operations that apply to the postal network including the planned expansion of businesses in the area of international express delivery.

### **Point of Observation on the Postal Network**

At present, Japan Post (the Postal Service Company after privatization, hereinafter referred to as Japan Post) is also engaged in the collection and delivery of parcel posts, namely “Yu-Pack” parcel service (referring to “ordinary parcel,” hereinafter referred to as “Yu-Pack”) via the mail

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<sup>1</sup>International logistic business, which Japan Post plans to enter, includes the door-to-door delivery of letters and packages, i.e., “International Express Business” and “Logistics Business” engaging in supply chain services among manufacturers and distributors.

<sup>2</sup>The name of the joint venture is “ANA & JP Express Corporation” with a ratio of capital contributions of 51.7%, 33.3%, 10.0%, and 5.0% by All Nippon Airways Co., Ltd., Japan Post, Nippon Express Co., Ltd., and Mitsui O.S.K. Lines, Ltd., respectively.

postal network for letters and postcards. When entering into the international logistic business, Japan Post plans to collect and deliver parcels for domestic delivery in the same way it does for parcel post business, via the same mail postal network.

In the postal business, scale of economy is generated based on the quantity of the services provided. Therefore, it is possible for Japan Post to utilize scale of economy through its postal network for parcel post business as well as the international logistic business, in which it competes with private operators. Such an approach appears in itself the economic and logical business behavior. Although entry by private corporations into the business of general correspondence delivery of letters and post cards is admitted by law<sup>3</sup>, no private corporation has so far entered such correspondence delivery business for the following four reasons:

1. The entry condition requiring the general correspondence delivery business to apply to provide universally fair services throughout the country (in principle, mail must be collected from about 100,000 posts stationed in Japan everyday from a unit of one mail per day and be delivered within three days) is too high;
2. In a network business, such as the postal business, the larger the network the operator owns, the better and less expensive services it can render, i.e., network externality counts to a large extent;
3. Venturing into new lines of business by providing the universal service, with no prospect for market expansion, is not economically feasible; and
4. Approval should be obtained from the Minister of Internal Affairs and Communications, who holds the jurisdiction of Japan Post, for the new entry. Currently, therefore, the general correspondence delivery business is the “monopoly area”<sup>4</sup> of Japan Post.

As Japan Post has sole possession of the economy of scale in its monopoly area, it has the competitive edge over others, creating a challenge in Competition Policy to ensure equal footing.

This report reviews the following: 1. framework of competition after the privatization of the postal service; 2. the postal network and the scope of economy; 3. institutional design to prevent anticompetitive acts by businesses with the monopoly area; and 4. review of issues related to the Antimonopoly Act.

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<sup>3</sup> “Law Concerning Correspondence Delivery by Private-Sector Operators (hereinafter referred to as Correspondence Delivery Law) was enacted in 2002. See Reference 1.

<sup>4</sup>The “monopoly area” mentioned in this report refers to the area of business which remains the monopoly area of a certain corporation as a result of severe entry conditions stipulated by business law and others. The study group headed by the Minister of Internal Affairs and Communications reviewed the issue of entry regulations set forth by the Correspondence Delivery Law and submitted a report in June 2006, based on the perception that the current regulations make it difficult for other private corporations to enter the mail delivery service. The study group also assessed the idea of establishing the “reserved area” for which exclusivity is permitted by law in order to provide universal service. See Reference 2.

# 1. Framework of competition after the Privatization of the Postal Services

## (1) Institutional Changes Coinciding with the Privatization of the Postal Services

As the Postal Law was revised in conjunction with the privatization of the postal services, parcel post and express post are removed from the category of “postal business”, which was previously included by the Postal Law. Therefore, these two services are no longer the compulsory universal service, which was previously the responsibility of Japan Post. As Chart 1 indicates, in the case of private operators, both parcel and express post business will be put under the jurisdiction of the Truck Business Law and Freight forwarding Business Law (hereinafter referred to as the “Trucking and Freight Forwarding Business Law”).

**Chart 1: Institutional Changes Related to Postal Privatization**

|                               |                             | Japan Post   | Private operators  |
|-------------------------------|-----------------------------|--|--|
| Letter (letter and postcards) | Correspondence delivery     | Postal Law (Mail post, “Yu-Pack”, booklet parcel, International mail, EMS) | Correspondence Delivery Law (See note), Truck Business Law, Freight forwarding Business Law            |
|                               | Non-correspondence delivery |  | Truck Business Law, Freight forwarding Business Law (Parcel delivery business, mail delivery business) |
| Parcel                        |                             |  |  |
| International letter/cargo    | Correspondence delivery     |  |  |
|                               | Non-correspondence delivery |  | Truck Business Law, Freight forwarding Business Law (Express delivery)                                 |

From October 1, 2007

|                               |                             | Postal Service Company   | Private operators  |
|-------------------------------|-----------------------------|--|--|
| Letter (letter and postcards) | Correspondence delivery     | Postal Law (Mail post), Truck Business Law, Freight forwarding Business Law  | Correspondence Delivery Law, Truck Business Law, Freight forwarding Business Law |
|                               | Non-correspondence delivery |  | Truck Business Law, Freight forwarding Business Law (mail delivery business)     |
| Parcel                        |                             | Truck Business Law, Freight forwarding Business Law (“Yu-Pack”/booklet parcel) (Parcel delivery business/mail delivery business) |  |
| International letter/cargo    | Correspondence delivery     | Postal Law (International mail, EMS), Truck Business Law, Freight forwarding Business Law  |  |
|                               | Non-correspondence delivery |  | (Express delivery)   |
|                               |                             | Truck Business Law, Freight forwarding Business Law (International logistic business)  | (Express delivery)   |

Note: No private operators have so far entered the general correspondence delivery business. However, 160 companies have entered special correspondence delivery business (delivery of 1. Correspondence which the total of length, width, and thickness is over 90cm, or which weighs over 4kg; 2. Correspondence to be delivered within three hours, and 3. Handling charges that exceed 1,000 yen), as of February 28, 2006.

While Japan Post applies a universal rate throughout the country to a portion of parcel posts regardless of parcel weights and delivery distance, private operators are required by the Trucking and Freight Forwarding Business Law to set the delivery fee based on the fair cost. The

Ministry of Land, Infrastructure and Transport indicated its position that countrywide universal pricing regardless of parcel weights and delivery distance may fall into discriminatory treatment<sup>5</sup>, and some people have pointed out that the planning of the same type of products may not be approved, thus violating the concept of equal footing in product planning. However, Postal Law currently requires that the pricing of the parcel post delivery fee be submitted to the concerned authority. Therefore, there was no room for a relative and flexible negotiation between the Japan Post and users. That is, there was a constraint, which did not allow Japan Post to provide discounts beyond the discount framework submitted to the Ministry of Internal Affairs and Communications. At present, parcel post service ("Yu-Pack" and booklet parcel) and the parcel delivery service and mail delivery service provided by private operators were essentially in a competitive relationship, but both were under the jurisdiction of different laws. After the privatization of the postal services, this problem will be improved to ensure equal footing in service competition. As well, the Postal Law requires that the pricing of letter post be approved now; but the notification system will be applied to only the first-class and second-class mail instead after the privatization of the postal services.

For international logistic business, Japan Post can enter this business area with the approval of the Minister of Internal Affairs and Communications from April 1, 2006. The Minister of Internal Affairs and Communications is required to hear the opinion of the Postal Services Privatization Committee if he receives an application from Japan Post for an entry into the international logistic business<sup>6</sup>. The Minister must do so to avoid an unfair treatment of other interested companies within the same business<sup>7</sup>.

## (2) Social Contribution Fund

On the occasion of the privatization of the postal services, the third-class mail provided by the Postal Service Company (periodical publications issued by organizations for the handicapped) and the fourth-class mail (mail that has raised letters and recordings for the blind) will be considered "social contribution business." If implementation of this service is difficult without lowering the level of service, there is a system, by which the management gains of "social contribution fund," funded by the sales of investments by the post savings bank and postal insurance company<sup>8</sup>. The grant

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<sup>5</sup> "Policies related to approval and license and transport cost (overview)" (website of the Ministry of Land, Infrastructure and Transportation)

(2) Basic principles of Business Improvement Order on Transportation Cost and Fees

i. In case of potential unfair discriminatory treatment against shipper

The cases in which certain major shippers or users of long distance delivery receive unfairly favorable discount rate, or when one shot customers and close range delivery users must pay a comparatively high price.

ii. Universal unit price per one parcel (in yen) is set up regardless of weight and distance.

<sup>6</sup> Article 33 of Postal Privatization Law

<sup>7</sup> Upper House Minister Takenaka's statement (summary) at the 162<sup>nd</sup> Special Committee meeting on postal privatization, No. 5 (July 20, 2005): "Upon the approval of this problem, the Minister of Internal Affairs Communications is in the process of regulating the procedure of hearing the opinion of the Committee on Postal Privatization, from the view point of ensuring that Japan Post should not unfairly harm the interest of other competitors."

<sup>8</sup> See Reference 3.

from this social contribution fund is available when the loss in the third-class and fourth-class mails including free mail for the blind cannot be balanced out even with the overall profits of the postal business such as the first-class and second-class mails<sup>9</sup>.

## **2. The Postal Network and the Scope of Economy**

As previously described, Japan Post plans to utilize its network of letter post for the international logistic business. In the following section, the current status of the network of letter post will be reviewed.

### **(1) Overview of the Postal Network Business**

#### **i. Reliance of Operating Income on Letter Post**

The postal business is roughly composed of three types of services:

1. Letter post (the first-class (sealed letters)/regular size and irregular size), the second-class (postcards), the third-class of periodical publications (newspapers/magazines, publications issued by the organizations for the handicapped), and the fourth-class of publications (correspondence study mails, magazines in raised letters, etc., and special handling of registered delivery and express).
2. Parcel post such as "Yu-Pack" and parcel post; and
3. International mail.

For the letter posts excluding special handling (hereinafter referred to as "ordinary letter post"), about 70% fall under the category of correspondence delivery as Chart 2 shows below. The total volume of mail handled by Japan Post in FY04 was 25 billion. The ordinary letter post is broken down to 11.66 billion of the first-class mail, 10.57 billion of the second-class mail (including New Year Cards and Election Cards) - making the total of these two types of letter post 22.23 billion; and about 690 million of the third-class mail, and about 40 million of the fourth-class mail. The total number of 22.96 billion ordinary letter deliveries occupies about 90% (about 91.8%) of all the mail. However, the share of parcel post is about 6% (5.7%) and international mail is about 0.3%.

As previously mentioned, no private operators have entered the general correspondence delivery business up to this point. In addition, the volume of mail handled by the special correspondence delivery operators is relatively small (about 930,000) compared to the volume of mail that Japan Post handles. Therefore, a distinctive feature of Japan Post's letter postal network is that it has correspondence delivery business which is almost monopolistic in Japan.

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<sup>9</sup> Upper House Minister Takenaka's statement (summary) at the 162<sup>nd</sup> Special Committee meeting on privatization of postal services, No. 5 (July 20, 2005): "In principle, the cost pertaining to the third and fourth class mails should first be effectively lowered in themselves by containing the cost as much as possible, and then should be balanced out by overall mail business. Therefore, social contribution fund will not be granted, if the overall mail business results in black ink figure."

**Chart 2: Breakdown of Ordinary Letter Post by Purpose of Mail (FY04)**

|         | Assumed to be correspondence (70.9%) |                       |                                   |                                  |                               | Correspondence & non-correspondence | Assumed to be non-correspondence (12.0%) |                              |        |
|---------|--------------------------------------|-----------------------|-----------------------------------|----------------------------------|-------------------------------|-------------------------------------|--|------------------------------|--------|
| Purpose | Application, inquiry, etc.           | Whereabout, greetings | Invitation to events and meetings | Financial related correspondence | Other business correspondence | Direct mail                         | Catalogue                                | Books, Magazines, newspapers | Others |
| Ratio   | 6.2%                                 | 9.8%                  | 8.2%                              | 32.1%                            | 14.6%                         | 17.1%                               | 5.4%                                     | 2.1%                         | 4.5%   |

Note: Mail under “financial related correspondence” includes invoices and receipts of payment, which are correspondence, and the checks, which fall under non-correspondence. “Other business correspondence” includes business report, contract documents, delivery notes, interoffice mail between head and branch offices. In addition, direct mail includes both correspondence and non-correspondence deliveries.

Source(s): Summarized from “Postal Service 2005”(Japan Post) and Reference No. 9 prepared for the fifth meeting of the Research Committee on the Postal Reserved Area and the Competition Policy (Ministry of Internal Affairs and Communications)

Chart 3 below shows the income and expenditure by mail class. Although the business scale in terms of the income of Japan Post has been diminishing every year, more than 80% of its income comes from the letter post (82.8% in FY04); while the ratio of income from parcel post is over 10% (12.7% in FY04), and international mail is about 5% (4.5% in FY04). From a business scale, as well as the volume of mail handled, it is clear that the major player in the postal network is letter post. Parcel post service is also provided by this postal network.

**Chart 3: Income and Expenditure by Mail Class**

(Unit: 100 million yen)

|   | FY03             |                   |                  | FY04             |                   |                  |
|---|------------------|-------------------|------------------|------------------|-------------------|------------------|
|   | Operating income | Operating expense | Operating profit | Operating income | Operating expense | Operating profit |
| Letter post                                     | 16,294           | 15,715            | 579              | 15,247           | 15,027            | 220              |
| First class(sealed letters)                     | 9,094            | 8,334             | 761              | 8,488            | 7,729             | 760              |
| Second class (post cards)                       | 4,727            | 4,572             | 156              | 4,485            | 4,467             | 18               |
| Third class(magazines , newspapers)             | 443              | 659               | ▲216             | 347              | 583               | ▲236             |
| Fourth class (correspondence courses, etc.)     | 16               | 45                | ▲30              | 12               | 38                | ▲25              |
| Special handling (registered delivery, express) | 2,013            | 2,106             | ▲92              | 1,914            | 2,211             | ▲296             |
| Parcel post                                     | 1,686            | 1,676             | 10               | 2,345            | 2,264             | 81               |
| International mail                              | 833              | 798               | 36               | 823              | 751               | 71               |
| Total   | 18,814           | 18,189            | 624              | 18,415           | 18,043            | 372              |

(Source(s): “Postal Service 2005,” Japan Post)



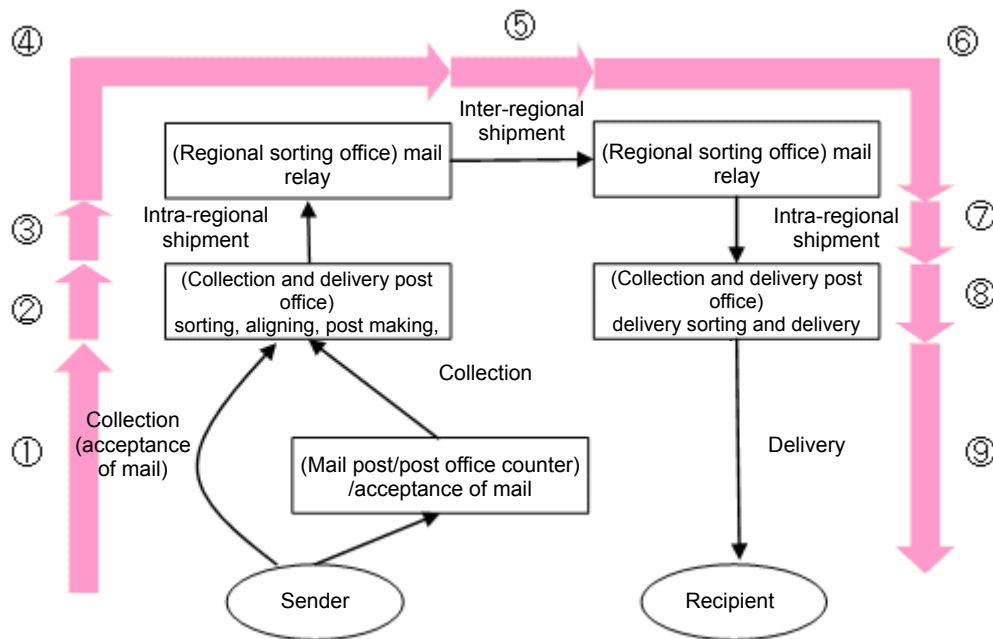
In the following section, the structure of domestic mail (domestic delivery of letter post, parcel post, and international mail), international mail, and the framework of international logistic business will be examined.

## ii. Structure of Domestic Mail

The common delivery network is utilized for the domestic delivery of letter post, parcel post, and international mail. As Chart 4 indicates below, the flow of delivery of domestic mail starts at:

1. The collection and acceptance of mail;
2. The task of sorting, aligning, post marking, and forwarding the mail at 4,726 collection-and-delivery post offices throughout the country;
3. The regional shipment of mail from office of origin to 83 regional sorting offices;
4. Mail relay by regional sorting offices;
5. The inter-regional shipment between regional sorting offices;
6. Mail relay by regional sorting office;
7. The intra-regional shipment of mail from regional sorting offices to delivery post offices;
8. The receipt, delivery sorting, and delivery plan by delivery post offices; and
9. The delivery of mail.

**Chart 4: Delivery Process of Domestic Mail**



The task at each process is summarized below.

#### Acceptance of Mail

There are two ways that mail is being accepted: one is that sender puts the mail in the post or brings the mail to the post office, and the other is that a Japan Post employee goes to companies to pick up mail. At the end of FY04, of the 24,678 post offices in Japan 4,726 offices operated as collection and delivery post offices. Collection and delivery post offices concentrate on going around the responsible area to pick up the mail from the post offices and mail posts, in addition to collecting mail from companies.

#### Mail Sorting

The mail collected at the collection and delivery post offices is sorted by size (sorting), postmarked (post marking), and divided by the location of recipients address (mail forwarding). About 700 collection and delivery post offices are equipped with a sorting machine, which automatically sorts, aligns, marks the post, prints an invisible bar code, and divides the mail by location (forwarding mail). After this process, mail is placed in a delivery case and palletized for shipping.

The processes described in and are jointly referred to as “mail acceptance” in a broader sense.

#### Intra-regional Shipment

The mail, which departs from collection and delivery post offices, is transported mainly by car to regional sorting offices (83 offices countrywide).

#### Mail relay

The regional sorting offices receive mail, which was shipped from within the region; they then sort the mail by region (by prefecture, city, etc.) and ship it.

#### Inter-regional Shipment

The mail, which departs from the regional sorting offices, will be shipped via air, car, or rail to the regional sorting office responsible for the region (prefecture, city, etc.) of the recipients.

#### Mail relay

The regional sorting office accepts the mail shipped from the originating regional sorting office, sorts the mail by post office responsible for delivery, and then sends it the concerned post office.

#### Intra-regional Shipment

The mail, which departs from a regional sorting office, is shipped mainly by car to the concerned collection and delivery post office.

The processes described in - are sometimes jointly referred to as “Mail relay” in a broader sense.

#### Delivery Sorting

The collection and delivery post office sorts out the mail received by town and street (delivery sorting), and aligns it based on delivery direction (direction planning). The collection and delivery post offices that are equipped with a sorting machine have the machine read the bar code on the mail, and align it by delivery direction. The larger mail, which cannot be sorted by machine, will be sorted manually and included in the mail that was sorted by the machine.

#### Delivery

The mail is delivered from the collection and delivery post office to each addressee (Japan Post servant or outsourced agency delivers by car or bicycle).

The processes described and are sometimes jointly referred to as “delivery”.

### iii. Cost Structure of the Postal Business

The business of Japan Post depends largely on manual operation in many processes such as mail acceptance, relaying, and delivery. Therefore, as Chart 5 indicates, about 76% of the operating cost is personnel cost, highlighting that the postal business’ cost structure is labor intensive.

Also, as Japan Post entrusts collection, delivery and shipment of mail to its subsidiary companies, consignment fees for mail collection, delivery and shipment account for about 10% of the total cost. In principle, Japan Post entrusts its subsidiary companies with all intra-regional (car delivery) and inter-regional shipments (by air, car and/or rail container), as Japan Post itself owns only smaller cars, such as two-wheeled motor vehicles of 50 cc (about 89,000), mini-vehicles (about 17,000), bicycles (about 9,000) and small auto trucks (about 2,000).

**Chart 5: Breakdown of Operational Cost of Postal Business in FY04**

| Expense item                                | Amount (unit: million yen) | Proportion (%) |
|---|----------------------------|----------------|
| 1. Personnel cost                           | 1,369,563                  | 76.3           |
| 2. Expenses                                 | 424,622                    | 23.7           |
| Fuels                                       | (6,514)                    | (0.4)          |
| Car repair                                  | (5,441)                    | (0.3)          |
| Postage (stamps, postcards)                 | (12,088)                   | (0.7)          |
| Depreciation cost                           | (74,847)                   | (4.2)          |
| Facility fee                                | (29,336)                   | (1.6)          |
| Consignment fee for collection and delivery | (169,842)                  | (9.5)          |
| Handling charge                             | (30,273)                   | (1.7)          |
| Others                                      | (96,277)                   | (5.3)          |
| Total                                       | 1,794,185                  | 100.0          |

(Source(s): "Postal Business 2005," Japan Post)

## **(2) State of Competition between Parcel Delivery business and Mail Delivery business**

### **i. Market Definition**

In reviewing the competitive relationship between Japan Post and other private operators, it is essential to define market. In fact, although it requires detailed data to examine the appropriateness of the application of the Antimonopoly Act, competition is reviewed in general terms in this section.

By developing unique products and services such as designated time delivery and cool-bin/cool delivery, which were not provided by Japan Post in its ordinary parcels, and generating consumer needs, private operators of parcel delivery service have extended the market. Although in the sense of small package delivery, the parcel post by Japan Post provided the same service as its competitors, the Post Office was not able to offer designated time delivery service. Consequently, the scale of competition was small.

Upon becoming a public corporation, however, Japan Post started active marketing by shifting the method of charging the basic fee of "Yu-Pack" (from weight of package to volume of package), introducing designated time delivery, expanding the delivery area for overnight package delivery, improving the discount system, and introducing new services such as golf-package service. As such, the competition between Japan Post and private parcel delivery service operators has become intense as Japan Post now offers similar type of products and services, and the fee is also similar to those of other operators. Therefore, it is appropriate to examine the domestic market for parcel delivery service, by including Japan Post's "Yu-Pack".

Japan Post also started booklet parcel as a service to deliver catalogues (non-correspondence delivery) in 1998. Other private parcel delivery service also started providing similar mail delivery service in 2003. Recently, as the booklet parcel has rapidly grown in volumes and competition among operators has become more intense, it is appropriate to include Japan Post's booklet parcel in the domestic mail delivery market.

## ii. Sales Comparison and Market Share

Chart 6 below shows the comparison between Japan Post and three major parcel delivery service operators, Yamato Transport Co., Ltd. (Yamato Transport), Sagawa Express Co., Ltd. (Sagawa Express), and Nippon Express Co., Ltd. (Nippon Express), in terms of sales and number of sales locations for postal business.

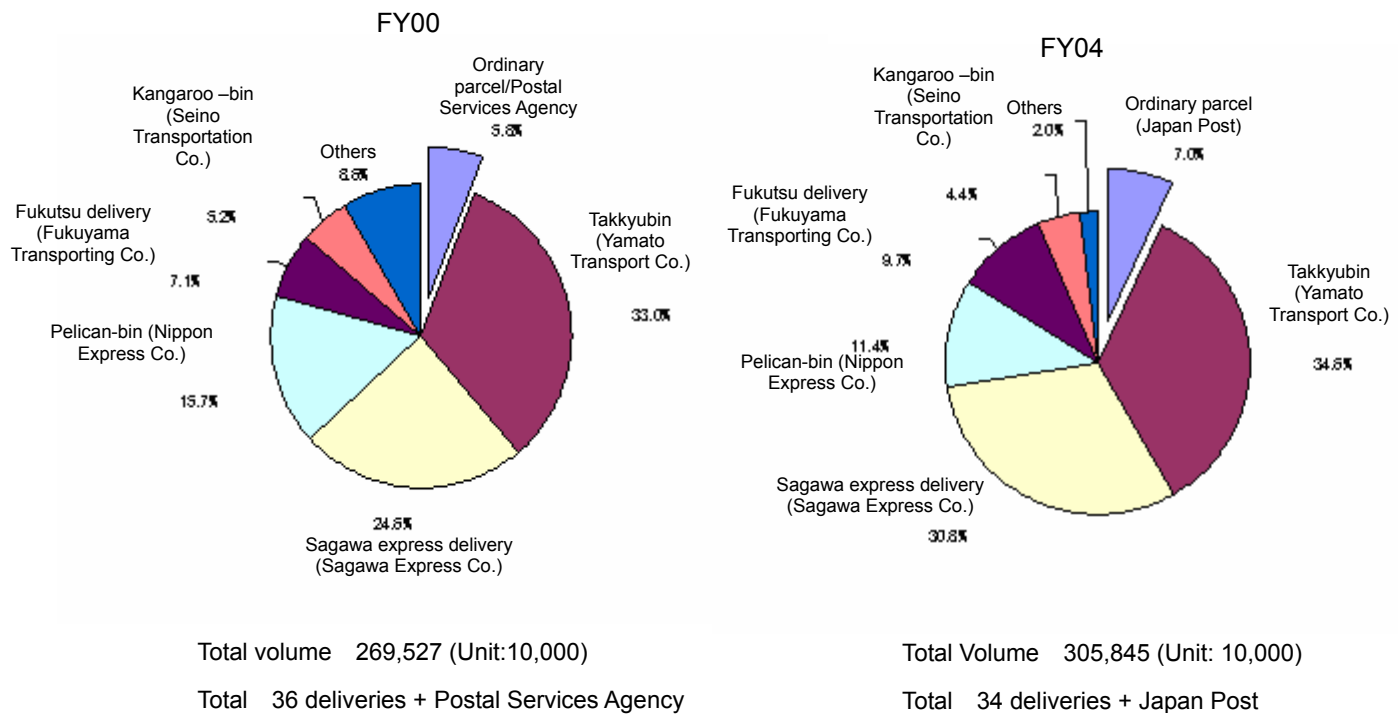
**Chart 6 Comparison of Sales Performance between Japan Post and Other Parcel Delivery Service Operators**

|                                       | Operating income<br>(unit: 100 million yen)  | Operating profit<br>(unit: 100 million yen)   | Number of service outlet<br>(number of locations)                 |
|---------------------------------------|--|---|---|
| Japan Post<br>(Mail service)          | 19,248<br>(out of which income from<br>handling parcel post is<br>2,345.)  | 262<br>(out of which profit from<br>parcel post is 81)  | Post Office: 24, 678<br>"Yu-Pack" station: 53,209                 |
| Yamato<br>Transport<br>(consolidated) | 10,719<br>(out of which income<br>from handling parcel<br>delivery service and mail<br>delivery service is 8,668)      | 535<br>(out of which profit from<br>parcel delivery service<br>and mail delivery service<br>is 362)       | Parcel delivery service 8,127<br>Service outlet: 306,986          |
| Sagawa<br>Express<br>(consolidated)   | 7,819<br>(of which no breakdown<br>figure for parcel delivery<br>service and mail<br>delivery service is<br>available) | 311<br>(out of which profit from<br>parcel delivery service<br>and mail delivery service<br>is available) | Sales store: 340<br>Service center: 99<br>Service station: 35,000 |
| Nippon<br>Express<br>(consolidated)   | 17,533<br>(of which no breakdown<br>figure for parcel delivery<br>service and mail delivery<br>service is available)   | 471<br>(out of which profit from<br>parcel delivery service<br>and mail delivery service<br>is available) | Sales store: about 1,100<br>Service outlet: about 170,000         |

Source(s): "Postal Service 2005" Japan Post, websites of above mentioned companies, etc.

The share of "Yu-Pack" in the total volume of handling small goods shipment by Japan Post (total of parcel delivery and "Yu-Pack") has been flat in recent years. Japan Post has been active in increasing this share by setting the goal of increasing the share of Yu-Pack" for FY05 by 10%. Most recently, it achieved an increase in the volume of orders from the subsidiary distribution company of Tobu Department Store and Daimaru Department Store (Associa Co.Ltd). The share of small goods shipment for FY00 and FY04 are indicated in Chart 7 below.

**Chart 7: Shift in the Share of Small Goods Shipment in Volume (Parcel Delivery Service and Ordinary Parcel)**



Source(s): "Performance of FY04 Parcel delivery service "by the Ministry Land, Infrastructure and Transport," Mail handled by type" Monthly Statistics by Japan Post

As Chart 8 shows, the delivery need for mail order catalogues and direct mail has been expanding. For example, the number of booklet parcels handled by Japan Post in FY04 doubled from the previous year, as a new discount system was launched in the same year to offer discount to those who send out more than 200,000 units of booklet parcels (flat fare is applied up to the weight of 100g per unit).

**Chart 8: Volume of Mail handled by Japan Post and Other Parcel Delivery Service Operators**

(Unit: million, %)

|                     |                 | FY00           |                | FY01           |                | FY02           |                | FY03           |                | FY04           |                |
|---------------------|-----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
|                     |                 | Number of unit | Rate of change | Number of unit | Rate of change | Number of unit | Rate of change | Number of unit | Rate of change | Number of unit | Rate of change |
| Japan Post          | "Yu-Pack"       | 155            | 0.6            | 162            | 4.3            | 166            | 2.6            | 182            | 9.9            | 215            | 17.8           |
|                     | booklet parcels | 156            | ▲6.0           | 249            | 60.3           | 277            | 10.9           | 516            | 86.5           | 1215           | 135.6          |
| Yamato Transport Co | Parcel delivery | 890            | 7.5            | 944            | 6.1            | 980            | 3.8            | 1007           | 2.7            | 1059           | 5.2            |
|                     | booklet parcels | —              | —              | 572            | —              | 606            | 5.9            | 994            | 64.0           | 1432           | 44.1           |
| Sagawa Express Co   | Parcel delivery | 663            | 23.9           | 818            | 23.4           | 879            | 7.5            | 925            | 5.2            | 943            | 1.9            |
|                     | booklet parcels | —              | —              | —              | —              | —              | —              | 153            | —              | 136            | ▲11.1          |
| Nippon Express Co   | Parcel delivery | 424            | 9.0            | 419            | ▲1.2           | 384            | ▲8.4           | 368            | ▲4.1           | 349            | ▲5.2           |
|                     | mail delivery   | —              | —              | —              | —              | —              | —              | 50             | —              | 30             | ▲40            |

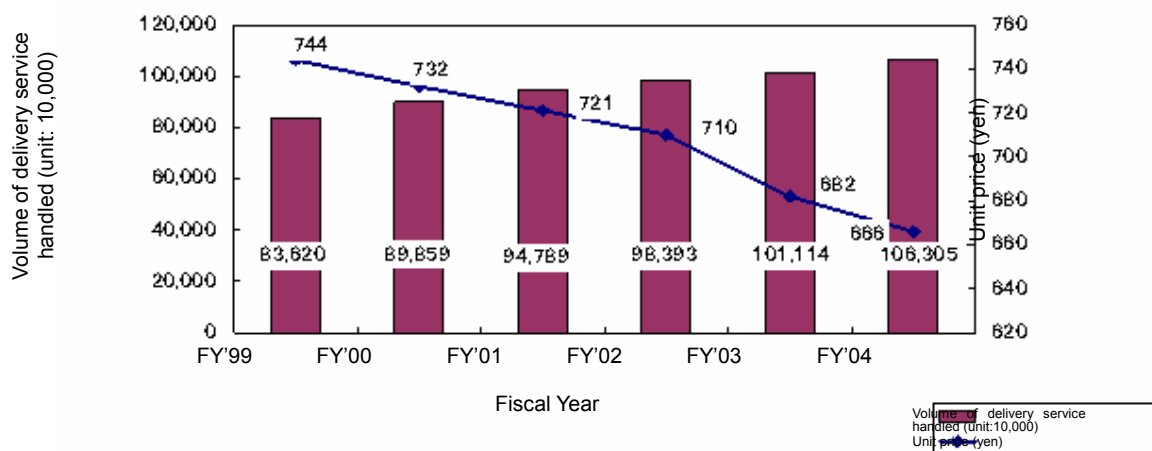
(Source(s): "Postal Service 2005" Japan Post, number of units of parcel delivery service (by truck), the Ministry of Land, Infrastructure Transport (FY1999-2004), number of units of mail delivery service (FY03, FY04), Yamato Transport

### iii. Condition of Competition

According to the Ministry of Land, Infrastructure and Transport, there are 34 parcel delivery services, such as "Takkyu-bin" by Yamato Transport and "Pelican-bin" by Nippon Express in Japan. As described in section ii above, the "Takkyubin" by Yamato Transport and Sagawa Express accounts for over 60% of the parcel delivery market, while the share by Pelican-bin of Nippon Express Co decreased from 15.7% in FY00 to 11.4% in FY04, highlighting the large changes in the market share in the past several years. Also, the "Yu-Pack" by Japan Post has grown in terms of volume since the postal service became a public corporation in 2003, supported by active marketing campaigns using young entertainers in commercials and lowering the service fee.

As Chart 9 below shows, the unit price for "Takkyu-bin" by Yamato Transport has been in a downward trend in the past few years, highlighting that the competition in price reduction in negotiation transactions with corporate clients has been actively implemented among competitors. It can be assessed that there is active competition in the market of parcel delivery service, including "Yu-Pack".

**Chart 9: Shift in the Volume of “Takkyubin” by Yamato Transport and its Unit Price**



4. Source(s): prepared from data publicized in Yamato Transport website

As of 2004, the number of operators for mail delivery service, including mail brochures, is 10, including Japan Post. The volume of mail brochures handled in FY03 was 1.85 billion, while that in FY04 was 2.95 billion, showing that the market of mail brochure delivery service is rapidly expanding in the face of growing competition.

### **(3) Entry into International Logistic Business**

#### **i. Structure of International Mail**

International mail services are provided in accordance with the Universal Postal Union Treaty. In Japan, Japan Post is responsible for providing international mail services at the fee stipulated in this treaty. The Universal Postal Union Treaty sets regulations to “provide universal and quality postal services which all the users in the world can enjoy permanently at a reasonable price in any location of the member countries.” At present, 189 countries and regions, including Japan, are members of this treaty.

Japan Post delivers mail to eight international mail exchange offices throughout the country via the same delivery network used for domestic mail, from which mail is sent to overseas destinations by means of passenger plane, etc. When the mail arrives at the destination country, the mail is delivered to the addressee via the postal network of that country.

International mail is separated into four groups in order of the least number of days required for delivery: EMS (Express Mail Service), Airmail, SAL (Surface Air Lifted/Economy air), and Sea mail. Although the services provided by EMS are specified in the Universal Postal Union Treaty, member countries are not obliged to provide this service. Thus, it is up to the postal service office of each member country to decide whether the services are actually provided. The particular services to be implemented are based on the bilateral agreement. As EMS is stipulated in Article 61, item 1 of the Universal Postal Union Treaty as being “the fastest physical delivery means among postal services,” it is the fastest method of delivering international mail. Japan has



a bilateral relationship with 121 of 189 member countries and regions of the Universal Postal Union (UPU) to deliver EMS. In Japan, Japan Post is handling those documents and parcels weighing less than 30kg.

Basically, the handling fee for international mail should be decided within the range recognized by the Universal Postal Union Treaty. Since, however, EMS is implemented based on the bilateral agreement, “the fee for EMS should be decided by the postal service office of the originating country by considering the cost related to the concerned services and market demand” (Article 61, item 4 of the Universal Postal Union Treaty).

#### ii. International Express Delivery Service

While international mail delivery is the concerted operation by the postal office of each member country providing the services via their postal network, international express delivery service emphasizes speedy delivery. Therefore, for international express delivery service, all the delivery functions related to international logistics<sup>10</sup> (from origin to destination) are integrated in that a general logistics operator (hereinafter called the “integrator”) provides the door-to-door services. Since international express delivery is fast, is provided by a single operator throughout the process, and provides package tracking services, it has grown rapidly in the past 30 years.

Both origin and destination countries must have a door-to-door domestic delivery network to enter the international express delivery market. Since the customer need for safe and speedy delivery are not satisfied unless the country is able to provide consistent services from mail pickup to delivery, the European market is oligopolistic by four major integrators: United States’ FedEx (Federal Express Corp.) and UPS (United Parcel Service of America, Inc.), Europe’s DHL (express mail division of Deutsche Post), and TNT (express mail division of Dutch TPG). These integrators are also actively expanding business in the Asian market, including China, which has been experiencing dramatic economic growth. They have already been engaged in active sales operations in the market of international express mail originating in Japan.

#### iii. Different Customs Procedures

When the international express delivery operator submits import and export reports and processes payment of customs duty on behalf of importers and/or exporters upon their request, it must obtain a license for customs broker in line with the Customs Law and have a registered customs specialist at each sales office.

To engage in import and export customs clearance and manage cargo, the international express delivery operator should 1) hold required financial resources to install and use the system terminal needed for customs clearance by NACCS<sup>11</sup>; 2) be required to keep foreign goods in the bonded area<sup>12</sup> and to prepare a ledger containing the name, quantity, and the date

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<sup>10</sup> Specifically, such functions include air and land transportation, customs clearance, and warehouse storage.

<sup>11</sup> Nippon Automated Cargo Clearance system, the custom clearance system, which Nippon Automated Cargo Clearance System Operations Organization (NACCS center) operates.

<sup>12</sup> Approval by a custom chief is required when establishing the bond warehouse as a bonded area.

of the entry of the goods, which entered the bonded area; and 3) submit required documents to and get an approval from the customs chief (in the case of imports, an approval is granted after customs duty is paid in accordance with self-assessed taxation method)<sup>13</sup>.

In contrast, as the simplified processes for importing and exporting international mails such as EMS are set forth in Article 76 of Customs Law, customs declaration in the bonded area and import and export approval are not required. When mail is imported from overseas, it is automatically transported to the international mail exchange office, and the full-time customs officer stationed there determines tax base based on the customs notice attached on the foreign mails, and imposes tax on the recipient (official assessment method is applied). The background that the tax declaration method was not applied to international mails is that around 1966, when the declaration method was adopted, 1) no competition with private operators existed as many international mails were sent in small lot; 2) proper tax declaration by mail recipients who did not know the mail contents could not be expected as most of the mails were sent unilaterally by senders; and 3) international mail was being handled by the government agency of Ministry of Posts and Telecommunications. In the United States, the self-assessed taxation method is adopted for international mail priced over a particular amount.

#### iv. State of Competition between International Express Delivery Service and EMS

As described previously, international express delivery and pick up service is provided, unlike EMS, door-to-door by an integrator via several delivery locations throughout the world by its own equipment and chartered plane. Thus the entire responsibility for mail shipment in all the processes rests with a single operator. Otherwise, an operator takes responsibility in collaboration with other private operators. Because of this, international express delivery is not only fast, but it also enables the assignment of delivery dates. In addition, what makes international express delivery service different from EMS is that its service area is broad, with 200 countries and regions throughout the world. It also ensures transparent shipment with the use of cutting-edge information systems to locate goods. In terms of handling fees, reflecting the services provided, international express delivery service fee is set for a higher level than EMS. For example, sending a small package weighing 2kg to Paris, France, by EMS costs 4,600 yen and takes about two days to reach destination<sup>14</sup>; the fastest operator of international express mail service can deliver mail to Paris in one day regardless of weekend and holidays, but charges 18,800 yen<sup>15</sup>.

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<sup>13</sup> International express mail delivery service has an advantage in the customs clearance process because the provisional office hour, which enables customs offices to be open at night, during weekends, and year-end/new year holidays. Also the pre-approval system, and prompt approval upon arrival are applied, enabling speedy, smooth customs clearance and mail delivery.

<sup>14</sup> It takes longer than two days, in case of weekends and holidays when delivery service is not processed.

<sup>15</sup> See Reference 4.

As indicated above, there are differences in the handling fee and services offered between EMS and international express delivery service. Recently, as in a part of the Asian region including China, overnight delivery has been made possible. Although available at a limited number of counter offices, though package locating service is provided in 50 major countries and regions, and the EMS network cooperation between 6 postal agencies including Japan Post has been strengthened<sup>16</sup>, some of the EMS services have become similar to international express delivery services, creating competition between EMS and international express delivery services. It is necessary to analyze detailed data to assess closely the competitive relationship between two mail delivery services. As some international express delivery service operators point out that a part of international express delivery operators have switched to servicing EMS, this report includes Japan Post's EMS in international express market in its review.

#### v. Scale of and Shift in International Express Market

According to the information published by "Japan Express Association"<sup>17</sup>, an industry association composed of four major integrators in Japan, these four companies account for 85% of the world's international express market. The daily caseload in the world's international express market has more than tripled in the past 10 years to 1.63 million, and it is expected to grow at an annual average of 13%.

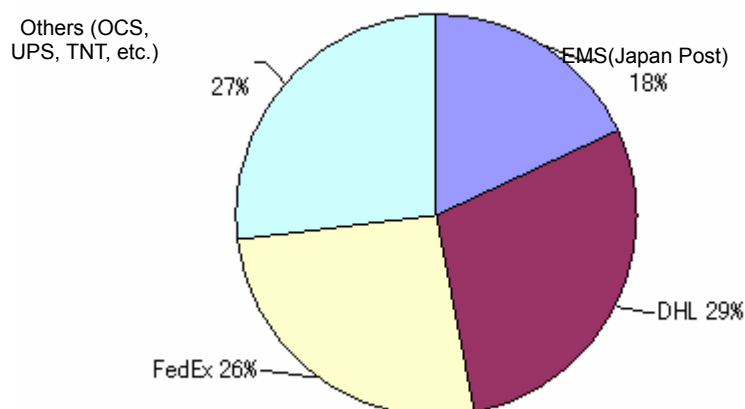
The size of the international express market in Japan (originating in Japan) is assumed to be about 100 billion yen and is expected to grow further. Chart 10 below shows the share of the market including Japan Post's EMS; DHL accounts for 29%, FedEx for 26%, and EMS of Japan Post for 18%; the total of the top three integrators account for about 73% of the entire market. In the other 27% of shares, Overseas Courier Service (hereinafter called OCS), a Japanese integrator, UPS (US), and TNT (Netherlands) are included, showing that the market is in tight oligopoly with HHI being over 1,800.

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<sup>16</sup> In July 2005, Japan Post announced that six postal agencies including Japan Post, State Postal Bureau of China, United States Postal Service (USPS), Australia Post, Hong Kong Post and Korea Post, which are all located in Asia-Pacific Basin jointly established a common network to provide EMS services.

<sup>17</sup> The name of Japan Express Association was changed to CAPEC Japan in September 2005.

**Chart 10: Sales Share in the International Express Market (Corporate Senders) Originating in Japan**



Source(s): Prepared from the briefing document for the president of Japan Post

Japan Post's EMS holds a market share that matches for the share held by major foreign integrators. As these major integrators are promoting sales activities for the mail business originating in Japan, by adding sales locations for example, the volume in number of parcels handled by Japan Post has remained flat in the past few years, as Chart 11 below indicates (EMS volume in unit of parcel originating in Japan for FY04 declined by 10% over the previous year).

**Chart 11: Changes in the Volume of EMS (Outbound)**

(Unit: 10,000 (%))

|                       | FY00      | FY01      | FY02      | FY03      | FY04       |
|-----------------------|-----------|-----------|-----------|-----------|------------|
| Volume<br>(unit, YOY) | 840 (9.7) | 870 (3.6) | 912 (4.8) | 945 (3.6) | 936 (▲1.0) |

( Source(s): Summarized from the data on the home page of Japan Post )

#### vi. Expansion of Business to International Logistic Business and Use of the Postal Network

The integrators have increased their sales offices and locations and expanded the area of delivery to which they can deliver parcels by their owned cars. With respect to the area to which they cannot deliver by their own cars, the integrators have sought to expand their countrywide network by entering into the partnership agreement with Japanese parcel delivery service operators<sup>18</sup>.

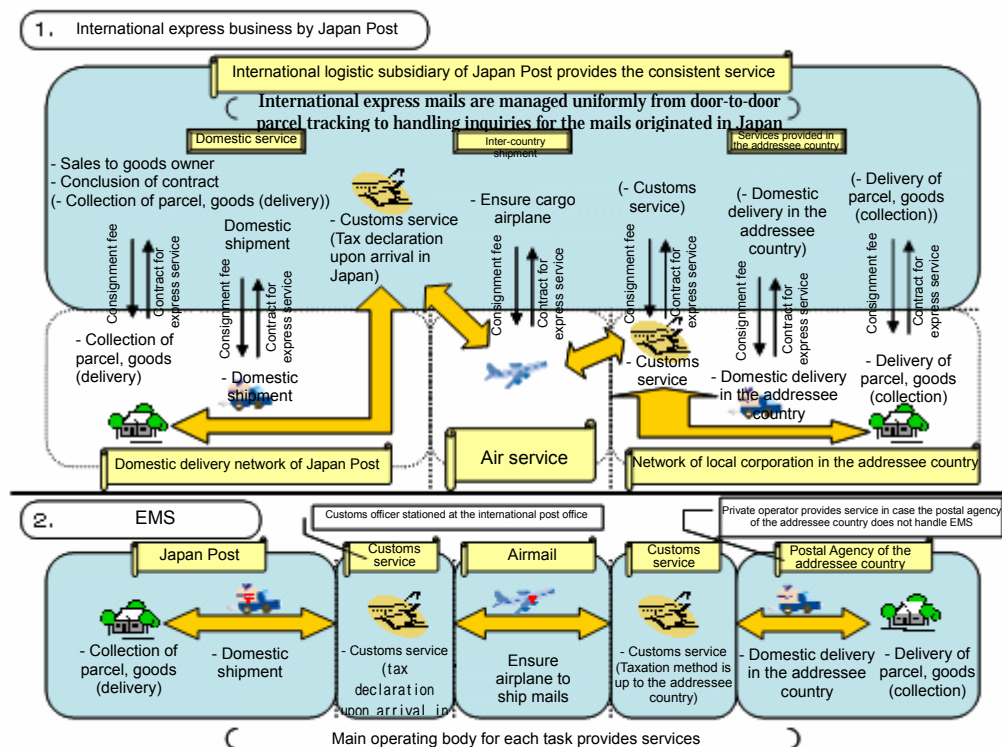
However, Japan Post announced that it would enter the international logistic business to

<sup>18</sup> DHL, for instance, has entered an agreement on business tie-up with Sagawa Express in September 1994 for delivery and collection service. It also entered a tie-up deal with Yamato Transport in November 2004 for the delivery of international mail (non-correspondence only) for Japan.

expand business base. It also plans to expand its international express business in Asian regions by, for example, starting an air service by cargo airplane owned by a joint venture with All Nippon Airways Co., Ltd., to the Shanghai region. The subsidiary, in which Japan Post puts up money to be engaged in international express service (hereinafter called the “Japan Post subsidiary”), plans to provide the consistent service, which offers the door-to-door locating of packages, responding to goods owners, and handling customs clearance, by entrusting the domestic mail delivery and collection to Japan Post, and overseas delivery and collection to local shipping companies, as Chart 12 shows below. Since the Japan Post subsidiary will use the postal network for domestic mail delivery and collection, Japan Post will be engaged in collection, delivery and shipment of international express mail, along with the sales, collection, shipment and house-to-house delivery of “Yu-Pack”. It is expected that Japan Post will introduce the services to be provided by the Japan Post subsidiary to the clients whom it delivers to and/or pick up the parcels from.

With regards to EMS, which Japan Post currently provides, domestic collection and delivery is taken care of by Japan Post, while the collection of delivery of the mail in the addressee country will be handled by its postal agency. Thus, EMS is the collaborative service provided via the postal network of each country. Because of this, the service quality and locating of goods depends on the postal network of the addressee country.

**Chart 12: Operational Image of International Express Service and EMS**



#### (4) Conceptual Summary of the Scope of Economy in the Postal Business

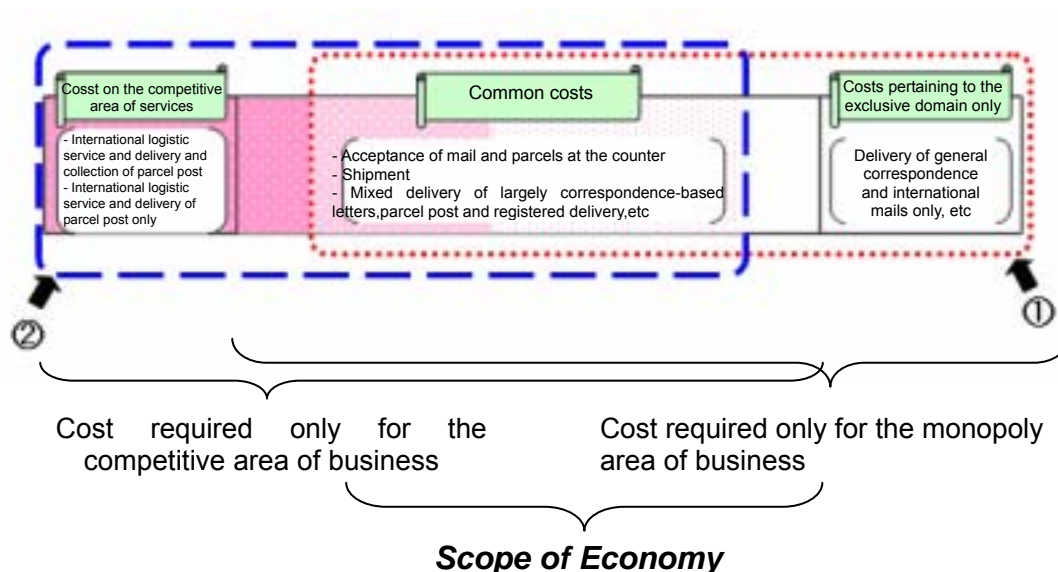
Japan Post can develop international express business and parcel post service via the postal network of the letter posts, which mainly receives mail, while it is difficult for its competitors such as international express service operators and parcel delivery service operators to enter the countrywide general correspondence delivery business. Thus, they are not able to develop a similar business model to the one that Japan Post can.

The concept of the scope of economy related to the use of postal network by Japan Post is reviewed below.

Chart 13 is a conceptual summary of the costs structure of the business, which applies to postal network. The costs pertaining to postal business are grouped into the costs on the monopoly area (correspondence of general and international mail), the costs on the competitive area (competitive service area with other operators such as parcel post delivery and the planned international express service) and the costs common to both areas of services.

If Japan Post offered services only on the monopoly area, most of the common costs would be still necessary in addition to the costs on the monopoly area to maintain the current service; if it were not engaged in the competitive business, the costs would occur in the area specified in in Chart 13. If Japan Post provided the services only in the competitive business, the required costs would be, in addition to the costs pertaining to the competitive area, those described in of Chart 13, even if it were not engaged in the business in the monopoly area, as most of the common costs would be necessary to keep providing current service. Therefore, the total costs when the separate bodies are independently engaged in the business of the monopoly area and in the competitive business, would be the total of and . However, when a single operator provides both services, it can save costs which overlap in those described in and , as it can share resources such as land, building, and acquisition and maintenance costs for collection-and-delivery vehicles that are required for business operation. Such advantage for costs saving is called the “scope of economy.”

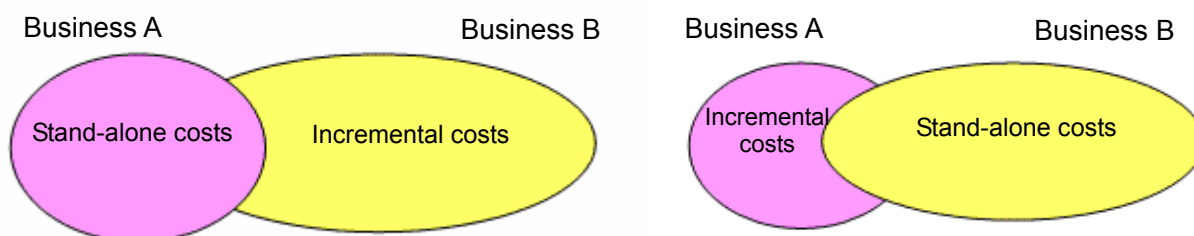
**Chart 13: Expense Structure of Japan Post**



The main service process for the delivery and collection of mail post and parcel post are previously described in Chart 4. Most of the costs required for the counter acceptance, collection, sorting, shipment, location sorting and delivery of mail and parcels are shared by letter post and parcel post. Although there are some differences in the types of letter, the cost on location sorting and delivery accounts for about half of the operating cost. For example, the same delivery staff sorts out the locations of addressees in order of delivery for both letter post and parcel post. For “delivery” operation, except for delivering the “Yu-Pack” by exclusive car in the urban area such as in the twenty-three wards of Tokyo, parcel post is delivered with letter post by light truck or bike. The scope of economy exists in this delivery process.

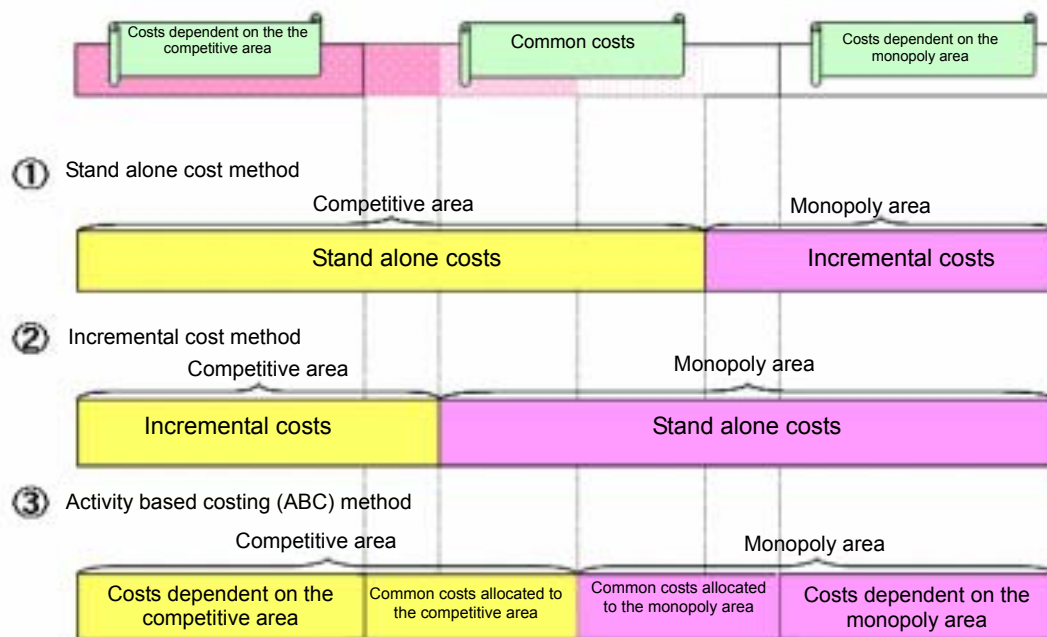
Therefore, from the perspective of ensuring equal footing for operators in the competitive relationship, the operator that holds the monopoly area of business should properly allot the common cost. There are largely three methods to allot common cost: stand-alone costing method, incremental costing method, and ABC (activity based costing method). First, the stand-alone costs are the costs required when a certain business is held by itself. Second, incremental costs are additional costs on another business, given that a service operator is engaged in one business. That is, as Chart 14 below indicates, the incremental costs are the remaining costs after the deduction of the stand-alone costs from the total costs, when a service operator provides two services.

**Chart 14: Relationship between Stand-Alone Costs and Incremental Costs**



The ABC method is used to allocate costs by identifying the source of common costs for business operations and allocating the costs for each operation. Chart 15 shows the organization of costs concept, which was mentioned earlier, applied to postal business.

**Chart 15: Organization of the Costs Concept**



### Stand-alone costing Method

This is the costing method used to calculate the stand-alone costs on the services provided in the competitive business area and treat the remaining costs as the expense for providing services in the monopoly area. In case the services in the monopoly area are not provided, the total costs minus unnecessary costs become the stand-alone costs on the business in the competitive area.

By applying the stand-alone costing method for the competitive area, and the incremental costing method for the services in the monopoly area, part of the common costs, those allocated as for the monopoly area are reallocated as the cost on the services in the competitive area, thereby contributing to the improvement of profitability of the business in the monopoly area. Also, if the cost reduction effect is large, one can expect that correspondence delivery fee may be reduced to return the profit to consumers.

### Incremental costing method

This is a method of calculating the costs of the business in the monopoly area by stand-alone costing method and treating the rest as business in the competitive area. The total costs minus the unnecessary costs for not being engaged in the competitive area are the stand-alone costs required for the business in the monopoly area.

### Activity based costing (ABC) method

This is a method of allocating the common costs, which are the costs that sum of the costs mostly depending on the competitive area and costs mostly depending on the monopoly area are taken from the total costs, by the distribution ratios which are calculated by identifying the time, space, or volume required for the businesses in the monopoly area as well as in the competitive



area as precisely as possible.

Japan Post introduced the ABC method when it became a public corporation and adopted the financial accounting system. In particular, 1) the flow of mail services is categorized by mail collection, originating, shipping, sorting, and delivery, and each cost is calculated by activity. For example, the personnel costs are calculated in terms of the ratio of working hours, and depreciation costs by operating hours and space; 2) the costs categorized by activity are further organized by the ratio of number or volume of items in accordance with the nature of activity in order to divide the cost by type of mail (i.e., first-class and second-class letter post, registered mail, or “Yu-Pack” , EMS, etc.); and 3) the costs allocated in accordance with each activity are added to calculate the cost by type of mail.

### **3. Institutional Design to Prevent Anticompetitive Acts by Business with the Monopoly Area**

At present, Japan Post takes sole possession of the scope of economy as it holds the monopoly area. Unlike Japan Post, parcel delivery service operators and international express operators cannot apply the scope of economy and compete with Japan Post by developing a network of letter post, mostly for correspondence delivery. From the viewpoint of competition policy, most preferable is to ensure equal footing in the competitive area, by eliminating the condition to provide universally fair services required for new entrants of general correspondence delivery business and encourage them to enter its business, and by eliminating the environment where Japan Post possesses the scope of economy.

When the drafts of the Law of the Privatization of the Postal Services were examined, revision of Correspondence Delivery Law was not considered. However, the group for studying the reserved area for postal services and competition policy hosted by the Minister of Internal Affairs and Communications examined conditions for private entry into the postal services and appropriate competition policy, and submitted a report in June 2006.

As the institutional planning to establish Correspondence Delivery Law is related to competition in the competitive area and to development of fair competition rules, flexible examination of an institutional system is essential. Thus, the Japan Fair Trade Commission would also review measures to establish the Correspondence Delivery Law and to ensure fair competition in the competitive area.

In the following sections, first, the design to ease the entry barriers of correspondence delivery business to realistically accessible level and institutionalize the universal service fund or subsidy to assure universal service will be discussed. Second, the design to institutionalize and require the opening up of the postal network to competitors for ensuring equal footing in the competitive area will be reviewed.

#### **(1) Lowering of Entry Barriers of Correspondence Delivery Business to Realistically Accessible Level**

##### **i. Basic idea**

The anticompetitive effect of business activities in the competitive area by the operator that possesses the monopoly area is derived from the fact that such operator uses the managerial resources in the monopoly area, which other competitors do not have. If competitors can use a similar business model to alleviate the cost burden by being engaged in both correspondence delivery business and international logistics business, through the lowering of entry barriers for correspondence delivery business to realistically accessible level, the concern about the anticompetitive act by the service operator that hold the monopoly area will be eliminated.

As described earlier, the conditions for a new entry into the general correspondence delivery business stipulated in the Correspondence Delivery Law requires the provision of universally fair services by collecting mail everyday from about 100,000 mailboxes located throughout the country, making new entry difficult. In order to promote competition in the general correspondence delivery business, it is essential to eliminate the requirement to provide universally fair service, approve the new entry in the area that is economically feasible, and promote the new entry first in the area of face-to-face acceptance of correspondence for business use.

In contrast, the reason for requiring the provision of universally fair service in the general correspondence delivery business is to prevent the situation where Japan Post cannot maintain the universal service because of cream skimming behavior by new entrants. Therefore, it is necessary to review the current correspondence delivery system and develop a system to both enable the maintenance of universal service and to promote competition through new entry into the general correspondence delivery.

#### ii. Mechanism to maintain the provision of universal service

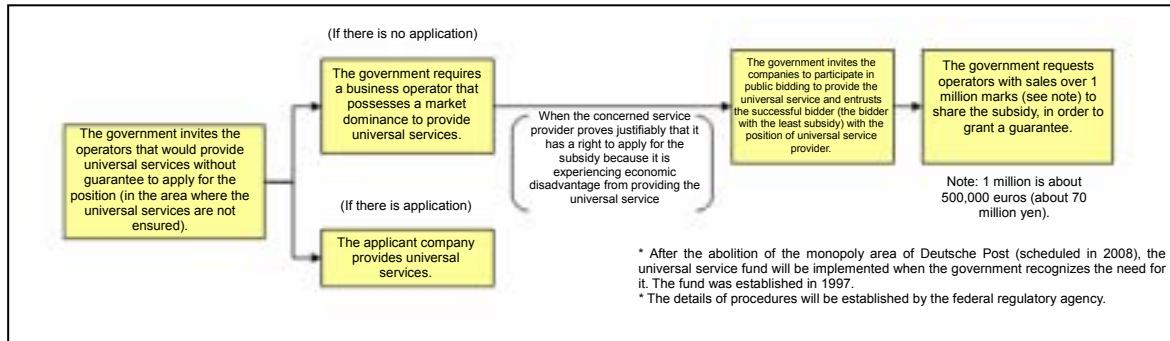
As a mechanism to alleviate the cost burden so that the provider of universal services can maintain the same level of service, other countries employ the universal service fund, government subsidy, or tax exemption (hereinafter referred to as “government subsidy, etc.”)<sup>19</sup> in establishing the universal service fund and government subsidy, etc. in Japan. It is appropriate to establish a system that avoids limiting the recipient of a government subsidy, etc. to Japan Post but also selects from the operators which amount of compensation is smaller.

In the United Kingdom, for example, the Royal Mail, which provides universal service, is exempt from value-added tax. In addition, during the period of three years since 2003, about 90 billion yen was subsidized to the Royal Mail. In France, too, the universal service fund and subsidy are established. While in Germany, as Chart 16 indicates below, the universal service fund is set up in preparation of the abolition of the reserved area. This system enables not only Deutsche Post but also other operators that provide universal services, to apply for the fund.

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<sup>19</sup> The universal service fund is the system for which, instead of setting up a reserved area, the service operators contribute financially to set up the fund, from which a certain amount is granted to the provider of universal services. However, the source of government subsidy is taxes and a certain amount of subsidy is given to the provider of universal services to maintain the same level of services.

**Chart 16 Universal Service Fund in Germany**



Source: Information material prepared for the second meeting of the "group to study reserved area for postal services and competition policy." Ministry of Public Management, Home Affairs, Posts and Telecommunications.

It becomes easy for new entrants concerned with payability to enter the economically feasible business first, if they are not required to adopt the system to maintain universal services, or to provide universally equitable services.

However, if such a universal service fund or subsidy system is established, the role of the fund or government subsidy, etc. and the social contribution fund stipulated under the relevant bills on postal privatization require clear definition. As described earlier, when a part of the business related to the third-class and fourth-class mail, which are considered as social action work, show a deficit, the first measure to be taken under the Law of the Privatization of the Postal Services is to cover the deficit with the profit of other letter posts. If the social action work is still in the red after such compensatory action, the implementation of social contribution fund is assumed.

When the universal service fund is newly launched, "balance-out earning cost method" may be used to compensate the deficit of businesses other than social action work. This method is designed institutionally to mobilize the external support with the use of fund, when the maintenance of universal services through cross-subsidization becomes difficult due to the increased competition in information and telecommunications field. The system is considered useful during the introductory period of competition in the postal business. When competition is enhanced to the full extent, the flexible application of such system observed in the information and telecommunications field is also possible as the adoption of the fund for the services least necessary (benchmark method) in the high cost region.<sup>20</sup>

Also important is to examine the level of postal services to be provided to all citizens, as a condition to maintain universal services. As, upon privatization of the postal services, the extent of the universal service was reviewed and the parcel post and express mail services were excluded from the postal business, the specifics of universal services are defined in accordance with user need and substitutability of other operators in each country. For instance, while in Japan, the letter

<sup>20</sup> See Reference 5.

must be delivered within three days of its acceptance<sup>21</sup>. In some countries, services that deliver mail in more than three days are defined as the universal service<sup>22</sup>. Thus, the level of universal services is different among countries. In consideration of the diversification of communication tools, such as internet and cell phones, and the cost required for providing services, it is necessary to establish a proper level of postal service, which is considered as the subject of universal service.

## (2) Opening up the Postal Network

As mentioned in section (1) i above, from the viewpoint of competition policy, the preference is to actually lower the entry barrier in the correspondence delivery business to the level where competitors can entry, and to open up the postal network to operators of parcel delivery services and international express services. If the postal network is opened up to other operators, the scope of economy, of which Japan Post takes sole possession, will be equally enjoyed by competitors. Additionally, if the entry barrier is made substantially lowered, other mail delivery operators who find it difficult to develop a delivery network by themselves can use the postal network and enter into the market smoothly. As a result, that contributes to the activation of competition in the field of correspondence delivery business. More specific discussions are provided in the following sections.

### i. Domestic and overseas status of openness of postal network

In other countries, the postal network is opened up to ensure equal footing for business activities in the competitive area, as well as to promote competition in the liberalized competitive postal business market.

In Germany, for example, Article 28 of Postal Law stipulates the licensee operator that holds a dominant position in the postal business (in the delivery of letters and small parcels of less than 20kg) is required to let other postal service operators use all its delivery means, upon a request for such use of each process by other operators, if such request is considered economical and rational. Thus, the postal network of Deutsche Post is open to its competitors.

When an operator newly enters the postal business of delivering the letters, which weigh less than 1kg, it needs to obtain a license categorized by the weight of mail and services. The new entrants, who deliver letters less than 1kg, account for 6.9% of the market (6.6% in terms of volume), the majority of which is value-added services to specify a delivery date<sup>23</sup>. As Chart 17 shows below, of these new entrants, those with a license for using the process of sending mail, which they collected, to the sorting center of Deutsche Post, and those with a license for using the

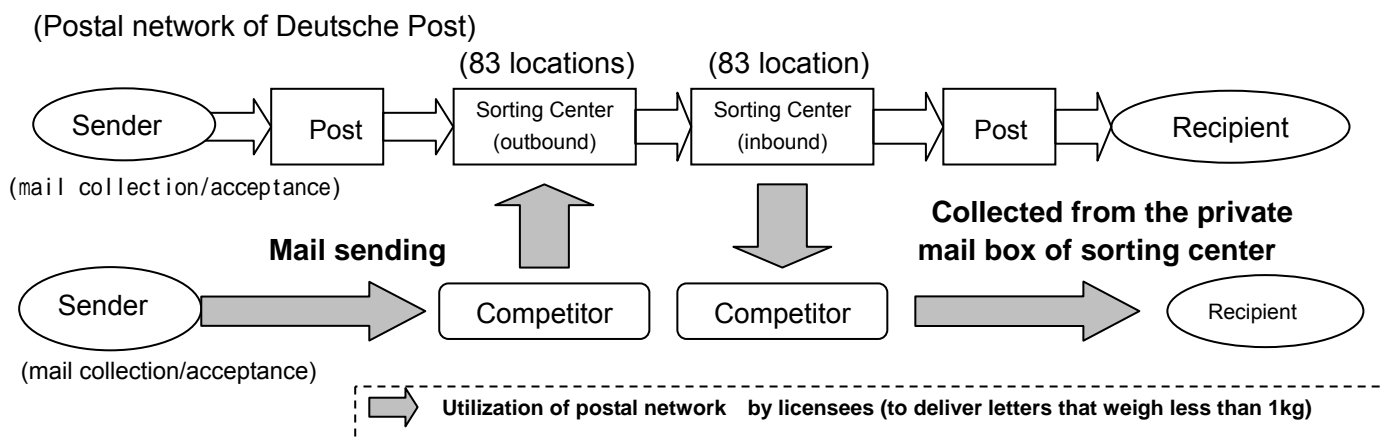
<sup>21</sup> The frequency of mail collection and delivery speed in Japan are as follows: At each mailbox, mail is received seven days a week, and five to seven days a week at the post office counter. Letter is delivered six days a week, more than once a day to the addressee. Letter must be delivered within three days of acceptance. As the service level of Japan Post has improved, the next-day delivery area has expanded to 84.5% in terms of population coverage. In most such places letter is actually delivered overnight.

<sup>22</sup> In the United States, about 47.5% of the mail is first class mail (delivered within three days of acceptance), about 46.4% is the standard mail (slow delivery), most of the latter being advertisement mail ("The Household Diary Study," USPS). In the U.K., too, there are the mail categories of first class (next-day delivery including Saturdays), and second class mail (three day delivery).

<sup>23</sup> Federal Network Agency "Annual Report 2005"

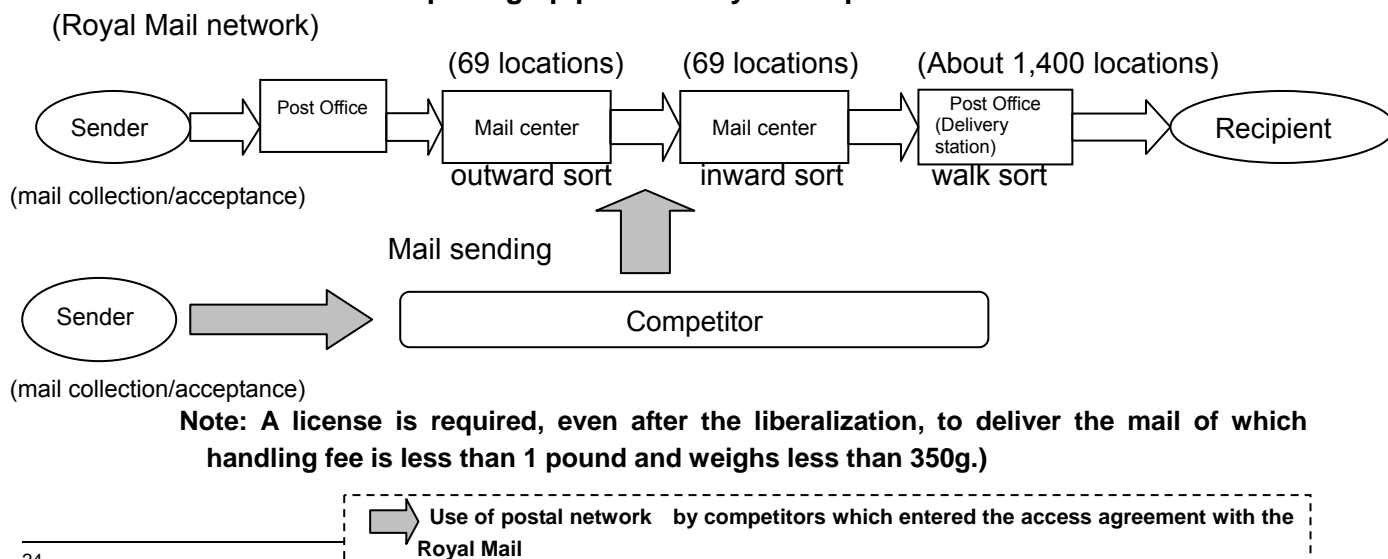
process of sending mail delivered to the private mail boxes at the sorting center of Deutsche Post, can participate in the business using the postal network of Deutsche Post.

**Chart 17 Deutsche Post scheme to open up postal network to licensees**



While the U.K. Royal Mail also opens up its network to competitors, the share of new entrants in the license market remains only 0.7%<sup>24</sup>. In the U.K., the Royal Mail is prohibited by law from discriminating against other competitors in accessing the postal network. As Chart 18 indicates, since September 2005, the Royal Mail has been delivering the mail for a fee that is brought to Royal Mail's mail center and sorted by postal code, in accordance with the publicized access conditions<sup>25</sup> and based on the access agreement with competitors, to the destination. Under these access conditions, the more the number of letters sorted by postal code with the same weight, the lower the fee competitors have to pay. For example, after April 2006, the delivery fee for letters up to 60g is set up for 13.89 pence per unit if they are sorted by about 120 locations designated for postal code. When the mail is sorted by the postal codes designated for about 1,400 delivery stations, the fee would be 13.40 pence. If the mail is sorted at even more locations (about 80,000), the fee becomes 11.97 pence.

**Chart 18 Opening up plan for Royal Mail postal network**



**Note: A license is required, even after the liberalization, to deliver the mail of which handling fee is less than 1 pound and weighs less than 350g.)**

<sup>24</sup> See Reference 6.

<sup>25</sup> Publication by Royal Mail "Condition 9 Access Agreement" (published September 23, 2005).

Upon the opening up of the postal network, some point out that there is no automatic machine to sort the letter of Japan Post and deliver documents of competitors to facilitate the shared use of the postal network. Even so, by following the examples of Germany and the U.K., it is assumed technically possible to open up the postal network in Japan.

Sagawa Express has already started providing the service named “Sagawa Yu Mail”<sup>26</sup>. The service brings booklet parcels accepted from its corporate clients to the post office, which Japan Post delivers to individual destinations by using its postal network. In addition, Japan Post offers a discount fee service<sup>27</sup> for corporate clients, who bring in the bulk of booklet parcels to the distribution station that Japan Post assigned to the area of the recipient’s address. Japan Post offers discounts to reflect the elimination of processes from collection to delivery, which the senders take care of in place of Japan Post. Therefore, it can be considered that a part of the postal network is used by competitors in the area of parcel post delivery business for corporate clients.

## ii Preferable form of opening up the postal network

### (i) Increased transparency of access conditions

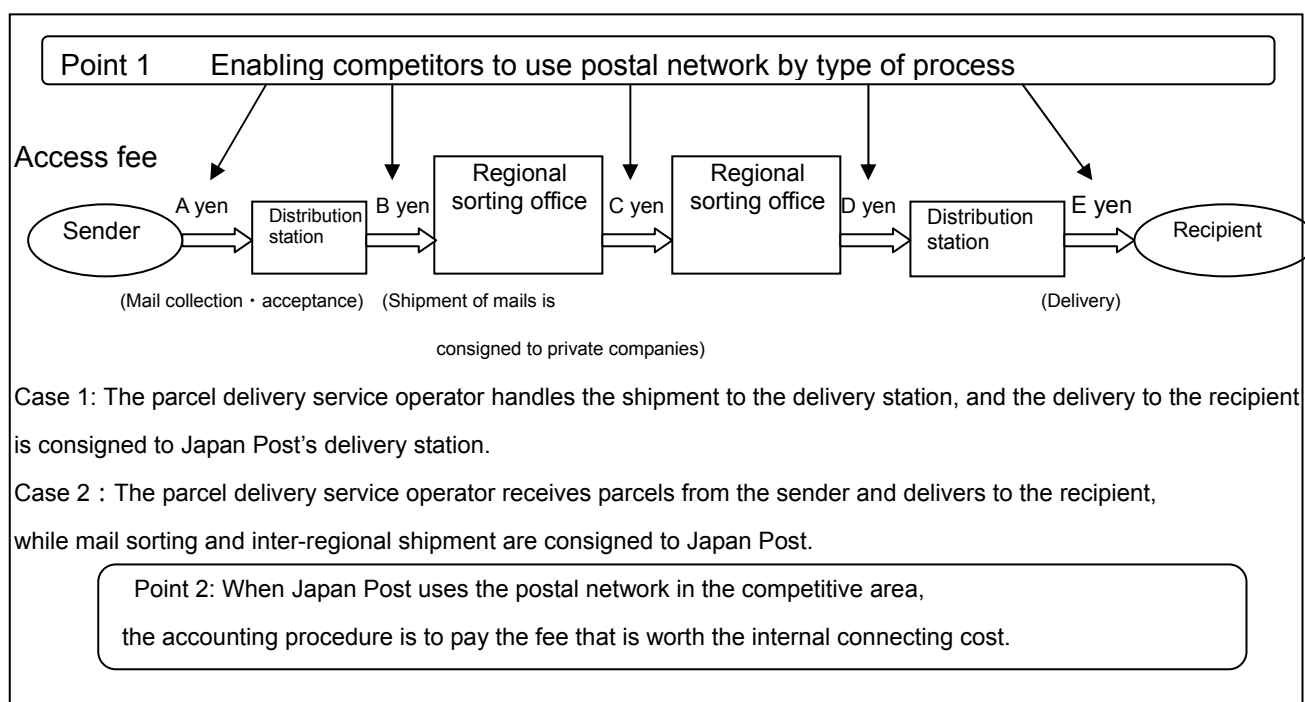
As Chart 19 shows below, in order for Japan Post to open up the postal network to competitors and share its use with them, it is essential to develop a system by which competitors can, in entering into the correspondence delivery business, receive Japan Post’s business at the cost equal to the amount it calculated by category of processes, such as mail collection and delivery. By taking such measures, it is possible to enable competitors to equally enjoy the advantage of Japan Post from possessing the scope of economy.

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<sup>26</sup> The “Sagawa Yu Mail” is the delivery service by which Sagawa Express accepts bulk printed materials, such as brochures, to deliver, sorts them by postal code, and bring them to the post office. In this manner, as the cost on the side of Japan Post is reduced, the handling charge is set for 110 yen per unit up to 200g of the minimum weight category. This fee is significantly cheaper than the fee for mail brochures, which is set for 210 yen for the same weight category (both are a flat fee throughout the country). The handling fee for mail less than 50g is also cheap when compared to the irregular mail, which costs 120 yen per unit.

<sup>27</sup> While the basic handling fee for booklet parcels up to 200g is 210 yen per unit, the fee for over 500 units of booklet parcels, which are brought into the delivery station is 95 yen per unit. For over 5,000 units, the handling fee per unit is 65 yen.

**Chart 19 Connecting image of postal network**



In terms of opening up the postal network, some of the major parcel delivery service operators view that, as the postal network is a social infrastructure, which Japanese citizens have relied on for many years, the preference is to develop a pricing system. The pricing system would reflect the proper cost of effectively using the postal network, particularly between the closest distribution station, regional sorting office or delivery station and the address of the recipient<sup>28</sup>. For example, as in the similar manner in the telecommunications business, the system, by which parcel delivery service operators pay a certain access fee to Japan Post, which, by using its postal network may deliver the parcels brought to the post office of the area of the sender or the recipient, may be developed. Specifically, in the area of telecommunications, dominant operators such as NTT are required to prepare the “Articles of Agreement Concerning Interconnection to Designed Telecommunications Facilities,” which stipulates the access conditions, including the connecting fee. In calculating the connecting fee, the “regulation on connecting fee” to obtain the cost by function is established, which sets forth that NTT’s affiliated operator and its competitors should be treated under the same conditions for connecting the telephone line<sup>29</sup>. In the postal business, too, we believe development of a system that requires the operators to prepare the “Access Clause,” and public discussions among interested parties on developing the “rules of access fee” should increase the transparency of transactions.

#### (ii) Opening up of network and clarification and increased transparency of accounting system

From the equal footing viewpoint, Japan Post should employ an accounting system through which to pay internally the fee comparable to the connecting fee, if it uses the postal network in the

<sup>28</sup> See Reference 7.

<sup>29</sup> See Reference 8.

competitive business field.

While Japan Post currently employs the ABC method for the accounting procedure, Postal Law requires reporting the operating income, operating expense and operating profit by each category of letter post, parcel post, and international mail. However, there is no regulation that stipulates the method of allocating the common cost by specific process. It is therefore necessary to clearly define the cost allocation method by process in the ministry ordinance in the same manner as in the public service, such as telecommunications, and increase the transparency, while responding to the expansion of Japan Post's business area. In particular, as regards the delivery process which accounts for almost half of the expense, a more specific and transparent cost allocation system should be developed, as the delivery mechanism for the correspondence, which can be delivered to the individual mailbox, and the delivery of parcel post that requires hand delivery to the recipient and receipt stamp are totally different.

### (3) Concept of Establishing the Reserved Area

At the study group hosted by the Minister of Internal Affairs and Communications, some major parcel delivery service operators presented its view to maintain transparency and abolish the reserved area in the future, even though a protective measure can be taken to ensure universal service. In contrast, Japan Post expressed its position that the reserved area should be clearly defined based on the outline and that a scope of liberalization should be expanded step by step from the perspective of industrial policy.

However, as explained in section (1) i) above, the base of correspondence delivery business is to actually alleviate entry regulations and promote competition. Consequently, the reserved area, which private operators cannot enter, should not be established. From the competition policy standpoint, even if establishing the reserved area based on the weight of parcels, it should be gradually scaled down and completely liberalized in the future. The specific schedule for the scale down and elimination should also be clarified. The scope of reserved area must be limited to the area required for securing cost necessary to perform the duty of providing universal service. For this, we consider that it is necessary to establish the reserved area, by calculating the profit, which reflects the related cost, by weight division, rather than by an ambiguous separation between correspondence and non-correspondence delivery.

In terms of overseas regulations, in the EU, for example, as a condition to liberalize the postal field, setting up the reserved area for the delivery of a limited weight for a flat fee (less than 350g of weight, and the delivery fee of less than five times the delivery fee for a basic letter type) to ensure the maintenance of a certain level of universal service was recognized in the EU directive in 1997 entitled "Directive of the European Parliament and of the Council on common rules for the development of the internal market of community postal services and the improvement of quality of service." In the following years, in the successive EU directives, the scope of the reserved area has been scaled down.

At present, the extent of reserved area is the delivery of mail less than 50g and delivery fee of less than 2.5 times of delivery fee for basic letters as Chart 20 below indicates.



As complete elimination of the reserved area in the EU is planned for 2009, the U.K. already abolished it in January 2006, and Germany plans to do the same at the end of 2007.

**Chart 20 Relationship between reserved area, competition area (license field), and universal service area**

**EU Directive**

Reserved area: letters and direct mail that weigh less than 50g and the handling charge is less than 2.5 times of basic letters


|  |                                     |  |
|--|-------------------------------------|--|
| Letter • Direct mail<br>(Reserved area)  | Letter, direct mail (less than 2kg) | } Universal service area<br>= Postal service |
| Parcels (less than 10kg), registered mail service, insured mail service  |                                     |  |
| Letters, parcels, express service, weight package, printed materials, direct mail, etc., other than those above. |                                     |  |

Note: In the letter category, books, catalogues, newspapers, and periodic publications are not included.

**Germany**

Reserved area: letters that weigh less than 50g and the handling charge is less than 2.5 times of basic letters

|  |  |                         |  |
|--|--|-------------------------|--|
| Letters (the reserved area of Deutsche Post)   |  | Letters (less than 2kg) | } Universal service area<br>= Postal service |
| Parcels (less than 20kg), newspaper, magazines   |  |                         |  |
| Letters, parcels, express service, weight package, printed materials, direct mail, etc., other than those above. |  |                         |  |

Note:  refers to letters less than 1kg, which require the new entrants of postal business to obtain license, for which efficiency, reliability and public safety are examined.

The EU directive also stipulates the separation of accounting process for the reserved area and competitive area to prevent cross-subsidization. More specifically, the Postal Law of the each EU member countries stipulates the separation of accounting process based on this directive. In Germany, for example, it is regulated in Article 10 of Postal Law.

For Japan, when the reserved area needs to be established, it seems desirable to first identify the reserved area by external feature such as the case of EU countries, and then clearly define the approaches to separate the accounting system for the reserved and competitive areas in order to increase transparency. It should be noted, however, that since Correspondence Delivery Law was enforced in Japan, concerned operators have developed a business model based on the assumption of separating correspondence and non-correspondence delivery business. For instance, about 60% of non-correspondence business by Yamato Transport is to deliver parcels less than 50g and the handling fee for those less than 100g is 80 yen at the least, which is the same price as that of Japan Post's handling fee for sending regular size mail. This indicates that Yamato Transport is in a competitive relationship with Japan Post. If the method of establishing the reserved area in Japan were changed to an EU regulatory model by weight, a

problem might arise, where some of the mail delivery business, which could be provided before, would be limited and the business, which was admitted, might be prohibited. Thus, when the reserved area is introduced, a certain arrangement should be made so that accompanying measures do not lead to tightened controls. For example, the German system recognized that mail over a certain weight sent out in volume of over 50 at one time as an exception to the business in the reserved area. Such an example could be used as a reference.

#### **4. Review of Issues Related to the Antimonopoly Act**

##### **(1) Basic Concept**

The Japan Fair Trade Commission strictly enforces the Antimonopoly Act on unfair trade practices, such as trending to cause difficulties to the business activities of other entrepreneurs by unjust low price sales, impending new entry, and excluding competitors from the market and on a substantial restraint of private monopolization and cartel in order to maintain fair and free competition in a market.

In section 3 above, we examined two institutional designs of correspondence delivery business to solve the problem of equal footing for competition, arising from the scope of economy taken sole possession by a certain operator with the monopoly area. In the following section, issues for several cases related to the Antimonopoly Act that may arise will be discussed.

##### **i. If the entry regulation of correspondence delivery business is substantively lowered to the level to enable others to entry into the market**

If the institutional design is implemented to enable substantively new entrants and the entry regulation on correspondence delivery business is lowered to the level to enable new entrants to substantively enter into the market, the issue of sole possession of the scope of economy is also eliminated. For universal service of delivering correspondence improved efficiency through competition and universal service can both be assured by introducing systems such as universal fund and government subsidy, etc. Though such institutional design may produce competition with new entrants, Japan Post, which possesses the countrywide postal network, is expected to remain a dominant operator, at least for the time being. In particular, in consideration of a large scale of network externality that makes new entry difficult and the cases of other countries, which are promoting liberalization, it seems difficult for new entrants to obtain a large market share in a short time. Therefore, if acts by Japan Post to require its service users in the provision of business to them not to do business with its competitors by taking advantage of its competitive edge, or to refuse unjustifiably services transactions with the users because they dealt with the competitors, while Japan Post holds the position as a dominant operator, such acts may impede fair competition. Those deeds fall under unfair trade practices, such as dealing on exclusive terms and refusal to deal. When a dominant company excludes the competitors from the market or controls other operators, and therefore causes substantively restraint of competition, each act falls under private monopolization which is a violation of the Antimonopoly Act.

## ii. If the postal network is opened up

As described in section i above, since Japan Post remains a dominant operator for the time being, it is essential to open up the postal network, even if the entry regulation on correspondence delivery business is substantively lowered, regardless of regulatory review. In opening up the postal network, Japan Post remains a dominant operator, at least for a while. It is therefore important to have an environment that makes fair competition possible for access by the competitors to the postal network upon its opening. If Japan Post refuses unjustifiably the access to its network by other operators, which are in a competitive relationship, or treats other operators discriminatorily, such deeds may impede fair competition in the market, and therefore, may fall under unfair trade practices, such as refusal to deal and discriminatory treatment on transaction terms. When a dominant company excludes the competitors from the market or controls other operators, substantively restraint of competition, each act falls under private monopolization which is a violation of the Antimonopoly Act.

## iii. Anticompetitive act by manipulating monopoly area

If the entry regulation of correspondence delivery business is not substantively lowered or the postal network is not opened up to others, the sole possession of scope of economy from taking the monopoly area is not eliminated, lacking equal footing for competitors. Therefore, it is necessary to monitor the market to prevent anticompetitive acts by the operator that takes sole possession of scope of economy in the monopoly area, particularly in the form of private monopolization and unjust low price sales, which act against the Antimonopoly Act.

# (2) Private Monopolization and Unjust Low Price Sales (predatory pricing action)

## i. Concept of below-cost pricing under the Antimonopoly Act

It is very important to identify how the common cost is allotted in determining whether the business activity of operator with the monopoly area in the competitive area falls under anticompetitive act. A typical example in Japan where the allocation of common cost was seen as a problem is the case of Chubu Yomiuri Newspaper Company<sup>30</sup>. In this case, Yomiuri Newspaper Company (hereinafter referred to as corporate headquarters) covered the cost, close to the stand-alone cost, for the common cost (editing cost) from which both the corporate headquarters and Chubu Yomiuri Newspaper Company took benefit, while Chubu Yomiuri reported the cost, which was considered as incremental costs. The issue of pricing based on such cost was contended to see whether it corresponded to below-cost pricing. In this case, it was determined that calculating the common cost based only on the incremental costs was invalid. The decision was made to determine the unjust low price sales by treating the expense reported in accordance with an appropriate allocation standard as the cost, and by assessing whether the price was set substantially below this cost.

Since this case focused the appropriate method of allocating the ordinary common cost, it is

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<sup>30</sup> See Reference 10.

necessary to define clearly the concept of private monopolization or unjust low price sales in the Antimonopoly Act that might be applied to the case of the operators with the monopoly area.

#### ii. Concept of the standard for below-cost pricing in EU

According to a precedent of Competition Law (EC Treaty<sup>31</sup>), there was a case of Deutsche Post in 2001<sup>32</sup> where Deutsche Post with the reserved area to provide mail order parcel delivery business in the competitive area at a price lower than cost took act by taking its possession of reserved area. It was decided that the deed was to exclude competitors from the market, and determined that such action violated the regulation on the “predatory pricing act by the dominant operator in the market” stipulated in Article 82 of EC Treaty. In this case, Deutsche Post agreed with European Commission to establish a subsidiary to provide business parcel business and report its income and expenditure for the coming three years to European Commission. This requirement was included in the decision by the Commission.

In the case of Deutsche Post, the decision was made through assessing the criteria of the below-cost pricing based on incremental costs rather than the traditional average variable costs<sup>33</sup>. That is, of the three cost allocation methods described in section 2 (4) above, the second method to use the incremental costing method for the competitive area, and the stand-alone costing method for the monopoly area, were applied. Very few presented criticism against the decision by European Commission. On the issue of European Commission making a decision of predatory price act based on the expense calculated by the incremental costing method, some pointed out that the criteria used for this decision would not facilitate fair competitive conditions because the cost equivalent of stand-alone cost is required when new operators enter into the market<sup>34,35</sup>.

#### iii Review of criteria for unjust low price

In assessing that a certain act falls under private monopolization or unjust low price sales under the Antimonopoly Act, the following will be used as criteria: supplying a service continuously at a low price, and exclusion or difficulty to the business activities of other entrepreneurs. It is thus necessary to examine these two criteria to monitor the business activities of the operator that possesses the monopoly area.

As there is a common cost for companies engaged in several businesses, the cost of commodities and services depends on the rules of allocating the common cost. Particularly, as the

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<sup>31</sup> See Reference 11.

<sup>32</sup> Decision by European Commission on March 20, 2001 (Deutsche Post AG) , [ 2001 ] OJL 125/27 See Reference 12. A similar example of predatory price action, the “Canada Post case,” can be referred to (see Reference 13).

<sup>33</sup> For instance, since cost on long distance shipment is still necessary to maintain universal service if parcel service is abolished, it is categorized in the expense of reserved area.

<sup>34</sup> Dr. Nicolaides of the European Institute for Public Policy criticized this point (see Reference 14).

<sup>35</sup> The “discussion paper on the application of Article 82 of the Treaty to exclusionary abuses Public consultation” published by the European Commission refers to the possibility of predatory price action when a market dominant operator with an advantage such as economy of scale whose competitors cannot match causes substantive damage to consumers by establishing a service price, which exceeds average total cost (see Reference 15).

common cost of network industry occupies a large weight, it is greatly influenced by cost allocation rules.

For general business, exploiting the scope of economy by being engaged in more than one business is a legitimate business model, which depends on the originality and ingenuity of each company. However, business activity in the competitive area by a company with the monopoly area to practice the scope of economy lacks equal footing, since competitors are not able to apply the same business model to compete. In addition, when the scope of economy is significant, there is concern that other companies cannot compete no matter how effectively they operate. They may drive out of the market, causing a substantial restraint of competition.

In the implementation of the Antimonopoly Act, the requirement is to examine the situation case by case. The prevailing thought, however, is that it is appropriate to assess the cost by stand-alone costing method for the business in the competitive area of the operator with monopoly area by taking sole possessions of the scope of economy. In accordance with this thought, it is desirable to calculate the commission fee basically by stand-alone costing method when Japan Post is commissioned by a Japan Post subsidiary to handle international logistic business. The Japan Fair Trade Commission will endeavor to make clarification of the stand-alone costing method, while listening to expert opinions, in case institutional measures, such as that entry regulation for correspondence delivery business is substantively lowered or the postal network is made open, to restrain anticompetitive activities .

#### iv. Criteria on the exclusion and difficulty of competitor business activity

Dumping, that is, unjust low price sales, is a type of act, which corresponds to “unfair trade practices” under Article 19 of the Antimonopoly Act, is defined as the condition where fair competition is impeded by unjustifiable means to compete as continuing low price and to “cause difficulties to the business activities of other entrepreneurs.” Whereas “exclusion” referred to “private monopolization” in the former clause of Article 3 of the Antimonopoly Act, is for a company to exclude its competitors from market by such act as an unfair trade practices, thereby substantively restraint of the competition. For example, by unjust low price sales, a dominant operator lures away new entrant’s clients and impedes new entrants, such acts fall under private monopolization. Furthermore, to be engaged in behavior that is highly probable to eliminate new entrants from the market with an intention to do so falls under private monopolization.

Generally, if an operator sells commodities and/or business at a low price in the business area where its market share is small, the influence it gives to the concerned business area is relatively small and doesn’t exclude competitors from the market. From this case, therefore, it cannot be concluded that the concerned company substantively restraint of the competition and the possibility that its act falls under the category of private monopolization is limited. Yet, it is possible for a operator with the monopoly area to exclude other competitors from the market by establishing a price level in the competitive area at a cost much lower than the cost by applying the stand-alone costing method, which is essential for assuring equal footing in the new market. This situation could occur in the international logistic business or in a business area in which the current market

share is low but where the share can grow rapidly because of its pricing advantages. Such possibility is even higher in a business area where public trust is high in public organization because of its years of business when combined with where the business entity has sufficient capability to provide services. This is also the situation when it is difficult to differentiate the commodities and services because of the nature of the business and where there is no specific technological advantage on the side of competitors.

If there is a fear that anticompetitive act by an operator with the monopoly area may be difficulties of competitors' business, it is assumed that such act falls under unfair trade practices. If market competition is substantively restraint, the act may fall under private monopolization.

In terms of the regulation on abusive use of market-dominant position stipulated in the EC treaty, an established, fundamental principle is if an operator in a dominant position in one market does not possess such a position in the neighboring or related market, the regulation on abusive use of market-dominant position is applied to this operator's act in the neighboring or related market as well.

### (3) State Aid's Distorting Effect on Competition

#### i. Concept of state aid regulation in EU

According to Article 87 of the EC treaty, state aid, which gives preferential treatment to a particular company or product, is prohibited except for those with social character, as the aid distorts competition. State aid is assumed to give economic advantage, which cannot be obtained under the general market condition and includes not only the government subsidy but also various kinds of state support measures such as taxation and regulatory preferential treatment.

In the case of the La Post<sup>36</sup>, it was decided that the use of the postal network infrastructure, which competitors cannot utilize in the competitive area at a low cost falls under the violation of state aid regulation. DHL filed dumping charges against its competitor, La Post, which is engaged in postal business in France, as the latter set up the commission fee it received from its subsidiary in express delivery business significantly lower than a normal market price. It is noteworthy that the case of La Post is similar to Japan Post's entry into the international logistic business, which has been examined in this report.

Some point out that, as regards the regulation on state aid, the responsibility of Japan Post to provide universal service reveals the characteristics of the state aid referred in the EC treaty<sup>37</sup>.

#### ii. Criteria for state aid regulation

Though the extent of social characteristics for which the application of state aid regulation is

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<sup>36</sup>The EU first hearing (December 14, 2000) (Ufex and Others), [2000] ECR -4055 See Reference 16.

<sup>37</sup> CPRC Discussion Paper Series "Competition and Regulatory Issues in Network Industries: Case Study Lessons for Japanese Telecoms and Postal Sectors," Shanker A. Singham. See Reference 17. The paper claims that the calculation of expense in the competitive area should be based on the stand-alone cost, in addition to the various privileges of being a public corporation (tax privileges, regulatory benefits, etc.).

exempted is provided in Article 87 of the EC Treaty, four conditions (Altmark test), which the European Court of Justice indicated in July 2003 for giving the subsidy to Altmark Trans, a German bus transport company, are now being used as the criteria. These four conditions are the subsidy is to be used for the business clearly defined in accordance with public duty, the subsidy is based on the pre-established objective and transparent indicator, the subsidy shall not exceed the amount required for performing public duty, and the required amount of subsidy is determined based on the expense analysis by an efficient operator<sup>38</sup>.

As regards the fact that the network of La Post, which possesses the reserved area, was used for the express business in the competitive area, the decision was made in the above-mentioned La Post incident, that state aid can be constructed “to support the logistics and operating business of the subsidiary of the operator engaged in public service, if the operator pays to the concerned subsidiary a fee lower than that required in the general market environment.”

### iii. State aid regulation in Japan

The state aid regulation in the European Union is applied to the subsidy given by member countries, which distorts or may distort market competition. As it is considered incompatible with the transactions in the EU market, state aid, which influences trade among member countries, is restrained.

In Japan, there is currently no competition rule that corresponds to the state aid regulation in the European Union. From the competition policy perspective, it is not by any means desirable that state aid gives a certain operator a competitive advantage and distorts fair competition. If a company receives state aid and uses that aid in a business other than the subject area of aid, the company harms the business activity of its competitors by exploiting a much lower business price than the cost, eliminates competitors from the market, or blocks new market entrants, such act may fall under unjust low price sales and private monopolization.

While economic structural reform has steadily progressed and privatization of public agencies and liberalization of public services is expanding, more areas in which the problems of the so called public oppression of private business that were not properly resolved are expected to emerge because no clear rules to solve such issue have existed before. Given this situation, the Japan Fair Trade Commission continues to coordinate with related government agencies on administrative measures to be taken by agencies required to implement a certain policy objective, so that such measures would not create problems on competition policy. The Commission will also endeavor to make clarification of the cost calculation criteria for the inheritance of public asset and subsidy of prerogative nature, while listening to expert opinion as necessary in order to put into shape the application of the Antimonopoly Act against dumping acts, which are manipulated by advantages that are not obtained through state aid or in the normal market condition. Also necessary is to examine the proper system to ensure the effectiveness of excluding public subsidy, which might distort competition, while taking into consideration the social influence and

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<sup>38</sup> See Reference 18.

administrative cost, which the same type of issue may cause in the future.

#### (4) Japan Post's Public Privileges and Steps to Ensure an Equal Footing

In accordance with institutional changes made in line with the privatization of the postal services, the same regulation will be applied to the Postal Service Company and private operators in the areas of collection and delivery domestic parcel and pick up of international letters and packages, which are not considered as postal matter.

However, international express delivery operators and parcel delivery service operators claim that Japan Post has public privileges over others as the traffic regulations under the Road Traffic Law such as parking ban and road closed to cars are not applied to vehicles used for delivery and collection of postal mail, the Postal Law stipulates that if the user of postal service requests forwarding the mail to a new address, and informs the Post Office of a new address, (mail should be transferred to that address)<sup>39</sup>, and the Customs Law recognizes simple procedures for the import and export of mail.

If after the privatization of the postal services, these public privileges facilitate further advantageous position for the "Yu-Pack", which becomes a subject of Trucking and Freight Forwarding Business Law as for private operators, booklet parcel delivery business, as well as the international logistic business which Japan Post intends to enter, they hinder the assurance of equal footing. Consequently it is essential to take some measures to ensure equal footing with the competitors of Japan Post.

#### Issues related to Road Traffic Laws and regulations

The traffic regulations under the Road Traffic Law, such as the parking ban and road closed to cars, are not applied to vehicles used for delivery and collection of postal mail. However, private parcel delivery service operators are not exempted from such regulation, nor are correspondence delivery operators<sup>40</sup>.

After the privatization of the postal services, parcel post delivery will be excluded from the subject of Postal Law, or from the subject of universal service provision, but becomes subject to the Trucking and Freight Forwarding Business Law. As the correspondence will no longer be mixed in the shipping bag with parcel post, it is assumed that the Road Traffic Law will be applied to vehicles that deliver only international logistic mails, "Yu-Pack", and booklet parcels, in the same manner as to the parcel delivery service operators. If such a measure is taken, for vehicles that

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<sup>39</sup> Article 44 of Postal Law (Article 35 after the revision of Postal Law scheduled for October 2007).

<sup>40</sup> The public safety commission of each prefecture determines the exemption of traffic regulations. For example, the Tokyo Metropolitan Traffic Regulation (Public Safety Commission Regulation, No. 9, November 30, 1971) stipulates that "vehicles which deliver postal mails" be exempted from the subject of the road closed to cars," and "vehicles that deliver mail or are in use to deliver telegraph" be exempted from the subject of parking ban and parking lot with limited time.

Under Yamagata prefecture's Road Traffic Regulation, "vehicles of Japan Post or private operators, which collect or deliver mail stipulated in Article 2, item 3 of Correspondence Delivery Law, or which are in use to deliver telegraph," are exempted from the subject of regulations such as the road close to cars. Thus the traffic regulations vary by prefecture.



ship both correspondence and parcel post mixed in the same bag still enjoy the advantage of being exempted from the application of Traffic Law, equal footing with competitors will not be ensured. As the private operators, which are subject to the Road Traffic Law, have taken certain measures, such as acquiring parking lots, the acquisition cost should not be overlooked. In order to ensure fair competition, it deems as appropriate to either admit the exemption of Road Traffic Law to the competitors of Japan Post in the same manner, or not admit such exemption universally, including Japan Post<sup>41</sup>.

#### ii. Issues on new address information

Postal Law clearly sets forth that when the recipient of mail reports his/her new address to the post office, Japan Post should transfer the mail to the new address. This system has been implemented for many years. Because of this system, Japan Post can use the new address information it holds to contain the rate of return. The distributors, such as department stores, significantly appreciate that the cost of processing returned mail is reduced. This is where Japan Post has an advantage over other parcel delivery service operators in competition with them.

In Sweden, with respect to sharing information on new addresses, the Swedish Post Office, which is responsible for providing universal service, established the Address Bank Company, to share the new address information with a new market entrant, named City Mail. Private operators in the Kansai area of Japan made an effort in handling the new address information. Kansai Electric Power Co., Inc. and NTT West Co. jointly established an organization that set up a new address information service system for collectively handling the processes related to user address change in consideration of personal information protection.

As Japan Post becomes a private operator after postal privatization, it is considered preferable, from the equal footing point of view, to establish a system as in the case stated above. Doing so would facilitate the provision of new address information by Japan Post to authorized operators other than Japan Post, when the user approves the sharing of his/her new address information by Japan Post and other authorized operators.

#### Procedural differences of customs procedure

When Japan Post established a Japan Post subsidiary to enter the international logistic business, it is assumed that Japan Post collects and delivers parcels. The parcels handled in the international logistic business by Japan Post becomes subject to the same customs procedure as private operators.

For postal mail, however, as was described in section 2 (3) iii above, simple customs procedures are approved. From the equal footing perspective, and in consideration of the substitutability of postal mail with international mails including EMS and international express business and the fact that in most of the OECD countries the self-assessed taxation system is adopted for international

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<sup>41</sup> From an equal footing perspective, the National Police Agency is currently considering, in principle, not to grant the exemption of traffic regulation to vehicles that deliver parcel post, including the "Yu-Pack", before the privatization of postal services.

mail when the handling charge is over a certain amount<sup>42</sup>, it is required to consider the changing of customs procedure, particularly for EMS, to the same procedure, which private international express operators have to follow.

## **Conclusion**

The structural reforms including the privatization of the postal services become meaningful if after such reform, the principle of market competition is mobilized, efficiency of new entrants is improved, and their profit is returned to consumers. This report has examined the issues, which need to be kept in mind from a competition policy perspective in adopting the systems, and proper regulation on correspondence delivery business market in line with the philosophy of the privatization of the postal services. In concluding the report, three points are emphasized.

First, given Japan Post's market dominant position, the institutional design of correspondence delivery business, international logistic business, and parcel post business should be reviewed not individually but by observing all related markets and considering their interrelating nature, in order to identify what is desirable for consumers. In this report, it was argued that Japan Post's postal network should be opened up to other operators, from the point of view that is important to ensure equal footing in the businesses such as international logistic business, which Japan Post plans to enter by applying its postal network, and improve efficiency and variety of the services through market competition. Through the opening of the postal network, competitors can also equally enjoy the scope of economy in the monopoly area of Japan Post. We also proposed to substantively lower the level of entry regulation on correspondence delivery business to the level where it becomes easy for new entrants to enter market. If the introduction of these measures eliminates the monopoly area in the future, the issue of possessing the scope of economy will also be solved. And, it is possible to maintain universal service, which consumers require, through the establishment of the universal service fund and subsidy, etc.

Second, it is essential for the Japan Fair Trade Commission to rigidly implement the Antimonopoly Act to avoid abuse of market dominance by Japan Post in correspondence delivery business. As stated in this report, the act by Japan Post, which possesses market dominance in correspondence delivery business, to unjustifiably exclude its competitors from the neighboring markets of international logistic business and parcel post business by applying its resources in correspondence delivery business, can fall under private monopolization and unfair business practice stipulated in the Antimonopoly Act. Particularly, if entry regulation for correspondence delivery business is not substantively lowered or the postal network is not made open, such behavior should be rigorously monitored through the implementation of the Antimonopoly Act. If after the privatization of the postal services, the expansion of Japan Post's business area is approved, while the efficiency of its business management is improved, the problem of abuse by Japan Post of its market dominance may increase. Actually, in other countries, there are disputes

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<sup>42</sup> Report by the "Study Group on International Logistics Service and External Trade," Ministry of Finance, (June 14, 2006).

related to the application of market dominance by the postal agency. Consequently, it is necessary to keep in mind that the same disputes may arise in Japan.

Last, it is important to ensure equal footing with competitors, which has been put forward as a basic philosophy of the privatization of the postal services. As described above, it is quite difficult for private operators to compete with the Postal Service Company if it carries out business by using its postal network in its monopoly area and possessing the scope of economy, while improving business efficiency upon privatization. Although preferential tax treatment will gradually be abolished, Japan Post has an advantage over others in the implementation of the Road Traffic Law for its postal business, of possession of users' new addresses, and in the application of simple customs procedures. These privileges, which only a certain operator can enjoy, should also be reconsidered to facilitate fair competition in each market.

In order for the privatization of the postal services to reveal a truly desirable nature in line with the basic reform philosophy, institutional management will be significantly important. Unless equivalent conditions are ensured for operators engaged in the same type of business, the basic philosophy of the privatization of the postal services results in lacking the finishing touch. The Japan Fair Trade Commission intends to pay close attention to the rigid implementation of the Antimonopoly Act in the postal business, which we reviewed in this report. Moreover, we continue to act toward these issues, recognizing that one of the important duties of the Japan Fair Trade Commission is to actualize the postal reform philosophy to consumer benefit, through continuing to review issues related to the banking and insurance industries, etc., where business fields are expected to grow.