17th Conference on Postal and Delivery Economics

May 27–30, 2009
Bordeaux, France

Presented by

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**Wednesday, May 27, 2009**

5:30 - 7:00  Registration
7:00  Reception
8:00  Welcome and Introduction to Conference: **Michael A. Crew and Paul R. Kleindorfer**
Dinner & Speech: **Joelle Toledano**, Commissioner, ARCEP

**Thursday, May 28, 2009**

7:30  Breakfast
9:00 - 10:40  **Concurrent Sessions**

**REGULATION I**  **PARAMOUNT-GAUMONT**
Chair: Bernhard Bukove
Discussants: João Castro, Greg Harman, Ian Rowson
**Antonio Amaral, C. Mota & P. Louro:** Assessing the Cost of Capital for the USP: a practical approach
**Geoff Bickerton, J. Sauber & K. Steinhoff:** Deregulation and the American and Canadian Posts: The Positions of Stakeholders
**Richard Bradley & P. Burns:** Regulation in an uncertain world: who needs price protection now?

**COMPETITION POLICY I**  **PATHÉ-UGC**
Chair: Chris Osborne
Discussants: Romain Ferla, David M. Levy, Ralf Wojtek
**Paul C. Smith & P. Vogel:** Transportation Outsourcing: A Team of Rivals
**Damien Geradin:** Dominance in the Postal Sector – The contribution of the Guidance Paper on Article 82EC
**Stephen Gibson & S. Holder:** Focussing regulation on bottlenecks: Perspectives on separation options

10:40 - 11:00  Coffee Break
11:00 - 12:40  **Concurrent Sessions**

**REGULATION II**  **PARAMOUNT-GAUMONT**
Chair: A.Lee Fritschler
Discussants: David M. Levy, Stephen Littlechild, Michael Scanlon
**Paul Schoorl:** Do-Not-Mail Legislation: Impacts on Mail Service and the Economy
**Jessica Lowrance & Rita Brickman:** Securing the Future of Universal Postal Service in the United States
**Greg Swinand:** The Theory and Practice of Setting the X-factor in Postal Pricing

**COMPETITION POLICY II**  **PATHÉ-UGC**
Chair: Joost Vantomme
Discussants: Derek Holt, Pekka Leskinen, Wolfgang Pickave
**John Hearn:** Nurturing competition in newly liberalized postal markets in Europe
**Richard Eccles:** National Regulation of Postal Services under the 2008 EU Postal Services Directive
**Mary Davies:** The Regulator’s Choice between Sector specific regulation versus Competition Policy

12:40 - 2:00  Lunch
Thursday, May 28, 2009 (CONTINUED)

2:00 - 3:30  Concurrent Sessions

**REGULATION III** PARAMOUNT-GAUMONT
Chair: George Kuehnbaum
Discussants: Robert Campbell, Eduardo Cardadeiro

**John Baldwin, Stephen Bell & Billy Hayes:** The review of competition in the UK postal industry-agencies, policies and outcomes

**Bénédicte Bouin, G. Lacroix & N. Curien:** Price Cap Postal Regulation: The French Experience

**Carlos Costa:** Independent Postal Utility Regulation: Necessity or Inutility?

3:30  Break

7:00  Reception

8:00 – Dinner & Speech: Jean-Paul Bailly, CEO - Groupe La Poste

Friday, May 29, 2009

7:30  Breakfast

9:00 - 10:40  Concurrent Sessions

**STRATEGY** PARAMOUNT-GAUMONT
Chair: Rob Sheldon
Discussants: Sven Heitzler, Montserrat Mir, Alberto Pimenta

**Peter Koppe, C. Bosch, S. Hömstreit & S. Pohl:** The economic crisis as reinforcement of e-Substitution in the mail market

**Neil Anderson & S. DeMatteo:** Remittances and the role of Post Offices in the financial structure of economies

**Leon Pintsov & A. Obrea:** Lessons from Postal Product Innovation

10:40 - 11:00  Coffee Break

11:00 - 12:40  Concurrent Sessions

**USO I** PARAMOUNT-GAUMONT
Chair: James I. Campbell Jr.
Discussants: Joan Calzada, Sven Heitzler, Sture Wallander

**Norma B. Nieto, M. Bradley, J. Colvin & D. Tobias:** The Cost of a Uniform Price Rule in Liberalized Environment

**Christian Jaag & Urs Trinkner:** Would the real cost of universal service provision please stand up? A calibrated approach to universal service costing and financing

**Philippe De Donder, H. Cremer, P. Dudley & F. Rodriguez:** Welfare and Cost for the Changes in Service Specification within the Universal Service

12:40  Break

3:00  Reception

7:00  Dinner & Speech: Jean-Paul Bailly, CEO - Groupe La Poste
Friday, May 29, 2009 (CONTINUED)

12:40 - 2:00  Lunch

2:00 - 3:30  Concurrent Session

**USO II**  PARAMOUNT-GAUMONT
Chair: James Pierce Myers  
Discussants: Jan Bart Henry, Leonardo Mautino

Robert Cohen, C. McBride & J. Panzar: The Value of the Postal Monopoly and the USO in the United States

Helmuth Cremer, C. Borsenberger, P. De Donder, D. Joram & B. Roy: Funding the cost of universal service in a liberalized postal sector

Joan Calzada, C. Jaag & U. Trinkner: Tendering Universal Service Obligations in Liberalized Postal Markets

3:30  Break

7:00  Reception

8:00 – Dinner & Speech: Robert Campbell, President and Vice-Chancellor, Mount Allison University

Saturday, May 30, 2009

7:00  Breakfast

9:00 - 10:35  USO III  PARAMOUNT-GAUMONT-UGC
Chair: Philippe Claeys  
Discussants: Henrik Baarlebye Okholm

Claire Borsenberger, D. Joram & B. Roy: The costs of universal service in the postal sector: a cross comparison of counterfactual scenarios

James I. Campbell Jr.: Historical Development of a Universal Service Obligation in the United States

Isabelle Carslake & G. Houpis: Evaluating USO Costs in a Liberalized Environment: A Comparative Analysis

10:35 - 11:05  Coffee Break

11:05 - 12:55  ACCESS  PARAMOUNT-GAUMONT-UGC
Chair: Michael J. Shinay  
Discussants: Gonzales d’Alcantara, Michael MacClancy, Stuart Holder


Shoji Maruyama: Future Problems Concerning Access in the Postal Market: Significance of Existing Bypass Networks


12:55 - 1:00  Concluding Remarks – Michael A. Crew

1:00  Lunch (Conference Ends)
The following edited books resulted from Previous CRRI Postal Events:

- Competition and Regulation in the Postal and Delivery Sector, edited by M.A. Crew and P.R. Kleindorfer, Edward Elgar, 2008
- Liberalization of the Postal and Delivery Sector, edited by M.A. Crew and P.R. Kleindorfer, Edward Elgar, 2007
- Progress toward Liberalization of the Postal and Delivery Sector, edited by M.A. Crew and P.R. Kleindorfer, Springer, 2006

The following are texts on postal economics:


These books are published by Springer and Edward Elgar. For information on ordering the books is available at either www.springeronline.com or http://www.e-elgar.co.uk/.

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17th Conference on Postal and Delivery Economics

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The conference will be held in Bordeaux, FRANCE. The conference site is:

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The hotel reservation forms can be obtained at our web site (http://crri.rutgers.edu/post/). The reservation forms must be sent to the Mercure Bordeaux Merideck Center. The Conference rates run from (for the American plan) 180,09 € single to 260,66 € for double including meals (Breakfast, Lunch & Dinner). The European plan run from 112,32 € for the single room and 133,65 € for the double. This plan includes ONLY breakfast. Please note on reservation form that you are attending the 17th CPDE (Rutgers University). The deadline for reservations is May 1st. However as hotel space is limited it may fill earlier than May 1st.

FEES AND EXPENSES

• A registration fee of $1,500 is payable to Rutgers University.
• Food and lodging at the Conference are not included in the registration fee. Breakfast, lunch and dinner are included in the rates for lodging. All persons that do not stay at the either the hotel will be required to pay for meals separately.
• The conference fee is waived for a limited number of employees of sponsoring organizations.
• Registered participants will be provided with
  o Online access to the conference proceedings
  o A CD-ROM with complete proceedings (papers and presentations) after the conference.
  o A copy of the edited volume resulting from the conference (approximately 6 months after the conference).

Please forward the Registration Form to Karen Walters at:
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CANCELLATION POLICY: Until April 17, 2009 cancellation is allowed without penalty and refunds will be allowed in full. After this date, the indicated fee is due in full whether or not the participant actually attends. Substitutions may be made at any time.

Signature of Participant: ____________________________
In the advent of the Full Market Opening (FMO) expected by 2011 within the EU member states, the issue of Cost of Capital for the postal incumbents and Universal Service Providers (USP) will be subject to a hard debate between operators and regulators. Indeed, the viability of the USP, its OPEX and CAPEX requirements under the Universal Service Obligations, implies a correct assessment of the expected return that the provider of capital plans to earn on his investment. The price control policy and alternative funding mechanisms must be thought carefully, taking into account the following dichotomy: return required \ allowed by \ to the USP.

The Capital Asset Pricing Model (CAPM) states that the expected return of a security can be calculated from the sum of the risk free rate and the product of its Beta and the market risk premium. Beta measures the association between the return of a specific security and the market as a whole. The market risk premium or the premium over the risk free rate is measured historically. The greatest challenge in estimating the cost of capital for postal operators is assessing the systematic risk of Equity. For instance, the use of the CAPM to measure the cost of Equity can be difficult because there is no uniform assumption regarding the risk free rate, Beta and Equity risk premium, which are the elements needed to compute the cost of Equity. The CAPM does have its merits, including the fact that it supports the view that higher risks require higher returns.

The Equity Beta estimation is a focal point for non listed companies. The Beta measures the part of the asset's statistical variance that cannot be mitigated by the diversification provided by the portfolio of many risky assets, because it is correlated with the return of the other assets that are in the portfolio. Beta is also referred to as financial elasticity or correlated relative volatility, and can be referred to as a measure of the sensitivity of the asset's returns to market returns, its non-diversifiable risk, its systematic risk or market risk. On an individual asset level, measuring Beta can give clues to volatility and liquidity in the marketplace. Beta can be estimated for individual companies using regression analysis against a stock market index. This is not a straight-forward task for most postal operators since the majority of them aren’t listed companies. This estimation cannot be replicated since we cannot read directly the sensitivity of the asset's returns to market returns. The Equity is, in general, based on a simple book valuation. A practical solution used by most postal operators consists on benchmarking the Betas of similar listed companies.

In this paper, we will assess the WACC (overall weighted cost of capital) and its components – the risk free rate, the Betas (Equity and Debt) and the risk premium (Equity, Debt and Market) – for the postal USP in most EU member states, North America, Japan, New Zealand and Australia and deliver further information on the relation between the WACC and the level of market opening.

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1 The views expressed in this paper are those of the authors and do not necessarily reflect the views of CTT Correios
References


Deregulation and the American and Canadian Posts: The Positions of Stakeholders

Objectives and Importance
On April 18, 2008, the Postal Regulatory Commission (PRC) in the United States of America (USA) invited public comment on universal postal service and the postal monopoly. On April 21, 2008, Canada’s federal government announced a strategic review of Canada Post. The Canadian government gave its review a mandate to examine regulations, the exclusive privilege or monopoly and the universal service obligation (USO). The objective of this paper is to outline the positions taken by major stakeholders during the consultations undertaken by the Postal Regulatory Commission and the Canada Post Corporation Strategic Review (CPCSR) in 2008. The paper will also identify any changes in positions which have occurred since the President’s Commission on the United States Postal Service in 2003 and the last review of Canada Post which was conducted in 1995-96. In short, it will update the paper entitled *Is North America preparing to embrace postal deregulation?* which was submitted for 16th Conference on Postal and delivery Economics, Rutgers University in 2008. The updated paper will be of interest to anyone who is following the public policy debate in North America and especially anyone who will be participating in the debate which will follow the publication of the reports of the PRC and CPCSR in 2009.

Summary

This paper will outline the process, including public consultations, undertaken by both the CPCSR and the PRC. It will also examine the reports of the CPCSR and PRC as well as any government response to these reports if there is sufficient time to look at this information prior to the deadline for Rutgers submissions. This paper will look at the positions taken by major stakeholders, including large volume mailers, representatives of small businesses, publications mailers, direct marketing organizations, competitors, non governmental advocacy organizations, municipalities, postal management and postal unions. It will note any significant changes in positions concerning deregulation which have been taken by organizations or constituencies since previous public reviews.

Methodology
The authors will analyse all of the statements and submissions presented to the PRC and the CPCSR and categorize and summarize results where appropriate. They will highlight previous positions taken by organizations wherever possible. As well, they will supplement the information contained in submissions by conducting individual interviews with the representatives of major mail users. The authors will evaluate the extent to which the stakeholder submissions are reflected in the PRC and CPCSR reports and any government response to these reports.
Regulation in an uncertain world: who needs price protection now?

RICHARD BRADLEY AND PHIL BURNS

The factors driving mail demand are changing. Recently, mail volumes have been declining in many countries and historic relationships between mail demand, price and economic growth appear to have broken down. These changes offer a new set of challenges for regulators and operators, affecting both revenues and pricing power in the mail market.

To date, the patterns of mail demand are consistent with several – often contradictory – explanations. The volume declines may be the result of increased mail price elasticities, with price sensitive consumers switching elsewhere. Or they could be the result of an exogenous shift in demand, with some customers using other media but price elasticities remaining unchanged. Alternatively, as customers with close substitutes switch away, the market could leave a residual core of customers with a very low sensitivity to price.

This paper analyses the balance of risks that regulators have to consider in the face of an uncertain demand environment. Regulators need to afford operators sufficient freedom to cope with reducing volumes, but still ensure that remaining customers are protected. Equally, regulators need to be sure that operators retain the pricing power needed to cover the fixed costs of the universal service, including the power to charge a price premium for premium classes or higher quality of service where required. Balancing these risks successfully may require new regulatory tools to ensure costs and revenues can move in parallel as demand changes, and to provide the right incentives for operators to adapt. Here, we review the evidence that can be used to discriminate between different explanations of changes in mail demand, and the theoretical and practical tools that regulators have at their disposal to respond.
Draft Abstract:

Transportation Outsourcing: A Team of Rivals

by

Paul Vogel and Paul Smith

December 5, 2008

Topic:

This paper will examine the implications of the U.S. Postal Service outsourcing of transportation and related processing of mail to competitors. The effort would be a joint endeavor of Paul Vogel (USPS) and Paul Smith (UPS), written from their institutions’ perspective as historic rivals and recent collaborators.

Value and timeliness of Paper:

Competing communication technologies are changing the underlying business model of the mail industry. Compounding this is the onset of a global recession that is reducing commercial mail, some of which is not predicted to return with better economic times. These well-documented factors are transforming the postal landscape and creating unprecedented pressure on postal operators to innovate, reduce costs and improve service.

The USPS has aggressively turned to public-private partnerships with UPS, FedEx, and other carriers for the transportation and related processing of mail, and thereby readdressing managerial and financial resources into the last (and first) mile delivery. While it is true that ample precedent exists for postal operators to outsource line-haul transportation, the novelty here is (a) the expansion of the scope and scale of that outsourcing, especially when drop-shipping and other work-sharing is considered and (b) the reliance on competitors to provide that transportation and processing.

There is a need to understand better the implications, both benefits and risks, for postal operators who may choose to follow the example set by USPS. Those that might consider that option would benefit from an examination of (1) the internal challenges within the postal operator and the private sector collaborators, (2) the potential legal and public policy questions such partnerships present, and (3) the economic and financial efficiencies that derive from such collaboration.
This effort would add to previous Rutgers’ Conferences on Postal and Delivery Economics that have looked at collaboration between mailers and postal operators through work sharing. See, e.g., Elcano, Mary S., R. Andrew German and John T. Pickett, “Hiding in Plain Sight: The Quiet Liberalization of the United States Postal System,” in *Current Directions in Postal Reform*, edited by Michael A. Crew and Paul A. Kleindorfer. Boston, MA: Kluwer Academic Publishers (2000).

**Methodology:**

The paper will lightly examine the history and prevalence of competitor collaboration (“co-opetition”, as Raymond Noorda framed it1) in other industries, with a deeper review of the USPS and UPS experiences. Competitive factors will necessitate a non-quantitative approach that will instead focus on the policy and related legal concepts, such as Ricardo’s law of comparative advantage, the overlay of competition law, and the application and limits of economies of scale.

**Disclaimer:**

The paper will reflect the views of the authors, and not necessarily the U.S. Postal Service or UPS.

Dominance in the Postal Sector - The contribution of the Guidance Paper on Article 82 EC

On 15 December 2005, the European Commission released a controversial Discussion Paper on Article 82, the provision of the EC Treaty dealing with abuses of a dominant position. This policy document, which was intended to be followed promptly by Commission guidelines on Article 82 EC, triggered a long and protracted debate not only among competition law experts (lawyers, in-house counsels, academics, economic consultants, etc.), but also within the Commission itself. While the Commission’s plan to move away from a “form-based” approach to the enforcement of Article 82 EC that sits uneasily with modern economic principles to an “effects-based” approach better in line with such principles was welcomed by all stakeholders, some aspects of the Discussion Paper were criticized as being unclear, impracticable, or still overly restrictive. Eventually, the Commission did not issue guidelines, but recently published (on 3 December 2008) a Guidance Paper describing the enforcement priorities of the Commission with respect to exclusionary abuses.

This Guidance Paper, which is considerably shorter and less detailed than the initial Discussion Paper, has received mixed reviews. While on the one hand, the Commission’s effort to explain the type of conducts that it is likely to investigate due to the actual or potential foreclosure effects they generate has generally been welcomed, some continue to think that the Commission still takes an overly stringent approach to dominant firm’s practices based on the restrictive law of the Community courts. For instance, while the Commission indicates that it will accept efficiency-based justifications for certain categories of rebates, the list of efficiencies the Commission seems willing to take into consideration appears to be restrictive. Moreover, this Guidance Paper does really not provide any “safe harbour” to dominant firms. While, for instance, the Commission states that prices above long-range average incremental costs (LRAIC) should normally not raise Article 82 issues, the Commission also states that there might nevertheless be circumstances where above cost prices may create foreclosure effects and thus trigger Commission intervention. Dominant postal operators pricing above costs thus have no guarantee that their prices will escape scrutiny under Article 82 EC.

This being said, considering the number of Article 82 EC cases currently being investigated by the Commission and the number of such cases pending before the Community courts, producing a Guidance Paper was obviously not easy an easy task, and the Commission should obtain credit for carrying out this exercise. This may explain why the Guidance Paper may be disappointing on some aspects, but it clearly has the merit to exist.

Against this background, the objective of the proposed paper is to review the implications of this Guidance Paper for the postal industry which has witnessed a number of important Article 82 cases in recent years. This paper will provide a detailed account the various kinds of practices
dealt with in the Guidance Paper, and which may be observed in the postal sector, including conditional rebates, tying and bundling, refusal to supply, and margin squeeze and for each of these practices discuss whether the Guidance Paper breaks new grounds or simply restates the existing case-law (and in particular the case-law, which has involved postal operators). Based on the priorities set by the Commission in the Guidance Paper, the proposed paper will also draw some general conclusions as to what postal operators should expect in terms of Article 82 EC enforcement in the months and years to come.
Focussing regulation on bottlenecks:
Perspectives on separation options

Stephen Gibson, Director of Economic Policy, Postal Services Commission
Stuart Holder, Associate Director, NERA Economic Consulting

Separation of the national postal operator has been considered as a policy option in the UK, as a means of promoting fair competition where new operators seek access to some part of Royal Mail’s network. As competition possibilities expand with full market liberalisation across the EU, similar questions may need to be addressed in other markets. This process may be facilitated by oversight in some countries by multi-sector regulatory agencies that oversee other industries that have already been broken up.

The consideration of separation options in the UK is partly a result of the apparent success of separation and market restructuring in other regulated industries (for example the creation of Openreach in the telecoms sector, which facilitated a rapid take-up of local loop unbundling, and energy market separations which have facilitated competition in retail markets). The break-up of industries previously served by single monopolists has allowed regulation to focus on those parts of the supply chain where natural monopoly conditions persist, and has allowed competition to be introduced elsewhere.

This paper will explore the way that separation has been implemented in other regulated industries, and consider the relevance of this experience for postal markets.

It will assess, among other things:

- the specific reasons why separation was proposed in other industries – for example was it in response to actual problems arising with competition or regulation, or was it a “preventative” measure introduced in advance of market liberalisation?
- the form of separation that was adopted – ranging from ring-fencing or accounting separation through to full divestiture;
- evidence of the costs of separation – covering both the initial implementation costs and any ongoing costs (which may reflect duplication of services, a loss of economies of scope or other impacts on operating efficiency);
- whether any additional regulatory safeguards have been introduced or retained following separation;
- whether separation has achieved its aim, and whether there have been any unexpected or unintended consequences.

The paper will then consider whether similar issues arise in postal markets, and whether there are any particular features of postal markets that suggest that the argument for separation is stronger or weaker than in other industries.

This part of the paper will cover, among other things
• a comparison of the particular separation options that have been suggested (both by Postcomm and by Royal Mail’s competitors) for Royal Mail;

• a discussion of whether separation is mainly a UK issue, because market entry to date has been largely by upstream competitors that need access to Royal Mail’s downstream delivery network, or whether similar issues are likely to arise elsewhere;

• criteria for assessing separation options, including
  – the impact on competition – will separation promote fair competition, but avoid distorting choices about the form of entry (eg upstream vs end-to-end)?
  – the impact on regulation – does it allow any relaxation in cases where tight regulatory oversight is currently required?
  – cost separability – can costs be easily split, are there “games” the operator can play?
  – operational separability – do issues such as revenue protection, service quality or operational flexibility constrain the options?
  – implementation costs – any there any major transitional problems?

• The paper will then consider how one separation model - accounting separation might be effected in Royal Mail between its pre-sorted upstream activities, its non-presorted upstream activities and its downstream activities. This will include discussion of the necessary financial disclosure methodology, provision of separate accounts, transfer pricing arrangements etc.

December 2008
Do-Not-Mail Legislation: Impacts on Mail Service and the Economy

Paul Schoorl (International Post Corporation)

One of the main challenges to direct marketers is the various efforts by external organisations and consumer activists to restrict the delivery of marketing materials through the mail. In the United States, Do-Not-Mail legislation has been proposed in twelve states this year alone (2008). There are concerns within the postal industry, that if Do-Not-Mail legislation is implemented it could have a major impact on postal volume and revenue. In cases where blanket regulations are passed, the business model which depends on advertising mail revenues and ensures that postal operators deliver today’s high-quality service at affordable prices, may become unsustainable. It is therefore critical for postal operators to understand and quantify the potential effects of legislation in order to plan effectively for the future.

Policies of this nature are often driven by concerns of consumer protection and privacy as well as the environmental impact of direct marketing activities. Where Do-Not-Call legislation has been successfully implemented, legislators are looking to apply similar regulations to mail activities. However, direct mail is in no way comparable to unsolicited and invasive telephone calls and is significantly more important for operating the universal service. The proposed study will look into the nature and size of the potential impact of Do-Not-Mail legislation on advertising mail as the issue has become more evident during the past few years. Furthermore, the study will also analyse the impact from regulations limiting advertising mail, which are currently in place in some countries. The final results should provide a framework for assessing the possible effects from anti-marketing initiatives.

IPC has completed an initial benchmark of current practice relating to this issue and has published the results to its members. This information will be used as a starting point for a more in-depth analysis of specific case-studies examining the impact of legislation on three different levels:

i. The impact on the financial health of the USP (universal service provider);
ii. The impact on consumer prices and/or availability of a high-quality service at an affordable price;
iii. The impact on the economy (sector losses, employment effects, trickle-down effects).

Several IPC members will participate in this project. Member involvement in the research continues by providing detailed understanding of the context and specific situations which have led (or could lead) to the introduction of regulations.

The final work will be a three-part report starting with an analysis of the advertising mail market in general and the context in which anti-marketing approaches take root. An overview of the privacy considerations and facts or belief about the environmental damage will be included. The second section of the paper provides an overview of the policies and regulations that emerge from the context outlined in the first section. The final section will assess the impacts that result from these anti-marketing mail initiatives.
SECURING THE FUTURE OF UNIVERSAL POSTAL SERVICE
IN THE UNITED STATES

Rita Brickman* and Jessica Lowrance†

Abstract

The underlying goal of the Postal Accountability and Enhancement Act of 2006 (PAEA) was to preserve the Postal Service's ability to carry out its statutory mission to provide universal postal service in the face of anticipated declines in mail volume and increases in costs. The legislation gave the Postal Service greater pricing and management flexibility, while also changing the law to promote fair competition, enhance transparency, and improve accountability.

Over the past two years, the Postal Regulatory Commission has conducted an array of proceedings to more specifically define the regulatory framework that Congress sketched out in the PAEA. We sit on the tail end of these proceedings. Now is an appropriate time to reflect both on what has been accomplished and what has yet to be accomplished, and consider how this new framework, as it continues to evolve, can enhance the Postal Service's ability to satisfy its overarching mission to provide universal postal service.

Such an evaluation is timely. Over this past year, the Postal Regulatory Commission conducted a proceeding in which the Commission solicited comments on universal service and the postal monopoly in preparation for making a report to the President and Congress on the same subject as required by the Postal Accountability and Enhancement Act of 2006. The PAEA requires the Commission to release that report by

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December 19, 2008. The issuance of this report follows on the heels of disastrous financial results for Postal Service FY 2008.\(^1\) It predates by only a few weeks a change in Presidential Administration and a new Congress. An assessment of the successes and limitations of the new law and regulatory framework in assuring that the Universal Service Obligation will be met well into the future can inform the prospective management agenda, the ongoing regulatory agenda, and new political leadership.

Furthermore, three years from now, in December 2011, the Government Accountability Office is required to present to the President and Congress an assessment of the future business model of the Postal Service, including evaluating long-term structural and operational reforms.\(^2\) At the same time, the Postal Regulatory Commission is required to assess the operation of the new postal law and make recommendations for changes\(^3\) To prepare to make recommendations, it is advisable for these government agencies to presently establish a framework for assessment.

Part One of this paper examines the aspects of the PAEA that influence the Postal Service's ability to meet its Universal Service Obligation, and considers the successes and limitations of the new law and regulatory framework as it has been implemented to date.

Part Two of this paper examines the changes the Postal Service has made in its operations and reporting in light of the passage of the PAEA, and offers the authors'\(^\)

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\(^1\) The U.S. Postal Service has reported a 9 billion piece decline, or 4.5% over the same period last year. It suffered a deficit for Fiscal Year 2008 of $2.8 billion. This economic loss occurred despite $2.2 billion in cost-cutting measures, including a reduction of 50 million work-hours compared to Fiscal Year 2007. The Postal Service's total debt now equals $7.2 billion and it almost met its $3 billion per year statutory borrowing limit as a result of the $2.8 billion loss. United States Postal Service Form 10-K; Periods Ending September 30, 2008, 2007, 2006 (Postal Regulatory Commission, USPS Periodic Reports, November 26, 2008).

\(^2\) P.L. 109–435 Sec. 710 (December 20, 2006).

\(^3\) P.L. 109–435 Sec. 701 (December 20, 2006).
observations on how the Postal Service will need to further transform itself or be transformed to continue to meet the modern universal service obligation. This section of the paper will draw on international experiences in postal reform to consider potential legislative and regulatory steps, consistent with the main goals of the PAEA, which may strengthen the Postal Service's ability to respond to current market conditions.

The paper concludes by examining the full range of flexibility that the PAEA provides to the Postal Service. Some of the biggest obstacles are not legal, but rather institutional. Recognizing these obstacles, both real and perceived, may facilitate greater experimentation with new services that could demonstrate potential to enhance revenues or reduce expenses.

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Gregory Swinand*

Abstract

The Theory and Practice of Setting the X-factor in Postal Pricing

This paper reviews the theory and practice of setting the X-factor in postal price regulation. The X-factor in general regulatory pricing is often seen as an ex ante exogenous productivity or efficiency factor. The idea is that a regulated industry might reasonably be able to achieve productivity or efficiency gains during the course of the price control, and the X-factor accounts for the regulatory lag by setting the rate at which efficiency should improve over time during the price control period. The X-factor, if truly exogenous and *ex ante*, need not decrease the incentive level or power of the control.\(^1\)

Setting the X-factor and the form, theory and practice of price control in the postal sector is of general and specific interest. First, many countries are still in the process of opening their postal markets. In the EU, for example, with few exceptions postal markets will become more liberalised in 2011 under the current postal directive. While legal protection will disappear, this is not to say that vigorous competition will appear overnight. The transition to competition will likely require flexible pricing regimes and possibly rethinking current price regulation as some aspects of the market will likely remain regulated. In fact, setting price caps and X-factors was an important part of telecoms liberalisation in the US, when regulating prices paid by long distance companies to local exchange carriers.\(^2\)

In spite of this seemingly straightforward general concept for X, different jurisdictions often use different concepts of the X-factor. While price caps date to 1982, there is still disagreement as to what X should be. We review the literature on the X-factor and what it should be at the start. Broadly, the UK and the US have taken two different approaches to X. In the UK, the X-factor is a broad efficiency factor (Littlechild 2003). The US, on the other hand, strongly influenced by work by Bernstein and Sappington (1999), relies on a solid definition of X as a productivity offset, a relative rate of total factor productivity growth and relative price changes. The UK and the US approaches led to two different schools of thought on how to design or choose X, with the UK approach eschewing a rigorous mathematical derivation and relying instead on a combined ‘judgement’ approach. Crew and Kleindorfer (1996) preferred this method.

The approach of the paper is to consider the empirical implementation of variously defined X-factors and study the results (e.g., higher or lower prices). We also consider the sources of the higher prices and trace them back to the theory (e.g., productivity offset X, TFP-based X, and the various components). We show that the US-style productivity-offset X relies on assumptions that are unlikely to hold empirically. Adopting the

\(^1\) London Economics
\(^2\) Long distance quickly became competitive while local exchange remained a monopoly.
productivity-offset X is likely to bias prices upwards relative to alternative definitions. We show that under the offset approach, using historical growth rates can lead to price growth in line with cost of service regulation. We propose a more direct X, where X equals the forecast of TFP growth less the difference between industry input and consumer price growth.

Finally, we review the practice of price making in the postal sector and consider the implications of our proposed definition of X in the context of some of the more important issues in postal pricing. We consider the implications of a productivity growth based X with entry, access, and a USO, by making certain assumptions about the structure of costs (e.g., quadratic average cost, Cohen et. al. 2004). Conclusions and directions for future research are suggested.

The paper builds on a number of different strands in the postal pricing literature, including Crew and Kleindorfer (1996) and Swinand and Scully (2006).

References


Nurturing competition in newly liberalised postal markets in Europe

John Hearn. Manager Postal Liberalisation (ComReg) and Vice-Chair CERP

By the end of 2010 95% of postal markets within the EU will be open to competition. This is expected to bring more innovation and customer responsiveness and reduced prices funded by efficiency improvements. But there is a danger, particularly in the smaller member states, that competition will not emerge and that de facto monopolies will replace de jure ones. The paper examines the underlying economics of postal service provision with a view to identifying how best to nurture competition, against the background of the economic and demographic characteristics of each member state.

In principle postal delivery networks possess sufficient opportunities to realise economies of scale and scope to make competitive provision of such services both difficult and (from a welfare viewpoint) undesirable. In practice, however, de facto or de jure monopolies remove the incentive to provide such services in an efficient manner, to innovate in the way the service provided responds to changing customer needs, and, in those cases where the operator has a de facto or de jure monopoly over upstream activities, the volumes may not be sufficient to fully realise efficiencies of scale and scope. As the European Court of Justice has observed ‘The creation and maintenance of [a state postal operator’s …] network was thus not in line with a purely commercial approach and would never have been undertaken by a private company.’

Essentially two models have emerged in markets where legal restrictions on providing postal services have already been removed.

- In some countries the existence of such economies of scale and scope is accepted and there is regulatory intervention to ensure that all upstream competitors can have access to the incumbents’ delivery network at a price that reflects the cost of efficient service provision. Not surprisingly in these cases competition is confined to upstream markets, and end-to-end competition is very limited, and confined to niche markets.

- In other countries there is no regulation of access to the incumbents’ delivery networks, and new entrants have developed end-to-end networks based on sorting being undertaken electronically as part of the mail preparation process and deliveries being undertaken on a limited number of days per week. In these cases competition is confined to the market for non-time-sensitive deliveries of mail posted in bulk.

The debate about which model to adopt has often been about the political or commercial advantages rather than an analysis of the underlying economic benefits for a particular country, and all its postal users. With the opening of postal markets to full competition in all EU countries it is essential that regulatory interventions are based on sound economic analysis.

This paper concludes therefore by analysing the economic conditions that are necessary to make each model a success, by exploring the opportunities to develop and facilitate hybrid-models, and by arguing against installing a prescriptive regulatory system that might not be flexible enough to encourage the emergence of dynamic innovative alternatives to current form of postal delivery.

* This paper represents the personal views of the author and should not be taken to represent the policy of ComReg, CERP, or any other organisation.
The 2008 EU Postal Services Directive achieves the important final stage of liberalisation through abolition of the reserved sector. This paper will analyse the key provisions of the Directive regarding liberalisation and related issues, including: first, increased pricing flexibility for the universal service provider (“USP”); second, the mechanisms introduced by the Directive for compensating the USP where the net costs of the universal service obligation constitute an unfair financial burden; third, quality of service obligations; fourth, the required scope of the universal service obligation; and fifth, the extent to which the universal service could be financed by other services of the USP which utilise the universal service facilities.

The over-riding objective of the EU Directive continues to be the safeguarding of the universal service. In a fully liberalised environment, cost-orientation and also cost-reflectivity for the USP are fundamental. It has always been a basic requirement of the Directive and that prices cover the actual fully allocated costs of the universal service and be affordable, even though the 2008 Directive contains a provision for incentivising efficiency of USPs.

The 2008 Directive further requires that any geographically uniform tariff must be limited to (basically) single piece tariff items. The Directive makes clear that in a fully liberalised environment, the USP should enjoy more pricing flexibility also for services to businesses, bulk mailers and consolidators, in line with the principle of cost-orientation. A national regulatory authority cannot require a USP to set universal service prices below the full cost of service provision unless the national regulatory authority can and does demonstrate that such a cost-orientated price is outside the range of “affordable” prices, in which case the Member State should implement a compensation fund or cost-sharing mechanism.

Further, the Directive does not impose any obligation to provide downstream network access, other than a non-discrimination requirement in relation to consolidators and direct access customers. Thus if a USP declined to offer any special terms to business customers for work-sharing or direct access to its network, it would not be required to offer any access terms to consolidators, under the Directive. This may not be a USP’s chosen policy (it could for example leave the USP exposed to greater risk of by-pass competition). However, the Directive does not impose any specific obligation on pricing outside the universal service or on the grant of downstream access by USPs (on a cost-orientated basis or otherwise). On pricing for services to business mailers, bulk mailers and consolidators (which includes downstream access), the recitals to the Directive envisage increased pricing flexibility for USPs in line with the principle of cost-orientation, though the recitals are non-binding. The Directive removes the possibility of any discriminatory treatment by the USP in this area as a potential barrier to new entrants, without going further, and in this respect is a liberalisation but not a pro-competition measure.
The Directive is the over-riding source of postal regulation in the Member States and its key provisions are binding on national regulators. National regulatory measures which are inconsistent with the Directive are in principle open to challenge by a USP (or any other affected postal operator), for example by way of defence to enforcement action taken by the regulator. In any event, the 2008 Directive will require EU member states to adapt their regulatory measures in a number of respects (apart from abolishing the reserved sector where they have not already done so), including the following provisions: ensuring cost-orientation of the USP’s prices, limiting the uniform tariff obligation to single piece tariff items, and a framework for establishing a compensation fund or cost-sharing mechanism to cover any unfair financial burden of the net costs of the universal service obligation.
Abstract for the 17th Conference on Postal and Delivery Economics 27-30 May, 2008

The Regulator’s Choice between Sector specific regulation versus Competition Policy

Mary Davies
Deputy Director of Economic Policy, Postcomm

Liberalisation of postal markets within Europe means that regulators increasingly face a choice between using sector specific regulation and competition policy.

Sector specific economic regulation in many cases is ‘ex ante’ regulation that identifies at the outset problems that exist within a market and seeks to provide the appropriate incentives, for example, to prevent conduct that may damage customers or competitors. It is constraining for the regulated company and for that reason, in economic regulation, its use is generally restricted to regulated companies in a dominant position. A common example of ex ante regulation is a “price control” which typically uses the “RPI-X” model. Other examples in the postal sector include service quality targets and headroom control. This paper is primarily concerned with regulation’s role in controlling anti-competitive behaviour rather than ensuring the provision of the USO.

Competition policy may be considered a form of ‘ex post’ regulation. Regulators can investigate and fine/impose directions on undertakings that have breached prohibitions on anti-competitive behaviour or failed to meet quality standards. Through competition law precedence is established which allows an understanding of which conduct might be considered abusive and what tests are likely to be employed to test whether conduct has been abusive.

Competition policy is sometimes described as ‘light touch’ regulation but to what extent is it possible to adopt such an approach within a postal sector? The paper will look at approaches adopted in different countries to assess whether competition policy has proved an effective tool. Based on these examples the paper will seek to answer a number of questions such as:

- At what point in the liberalisation process does it become appropriate to consider using competition policy?
- What factors are likely to impact on this decision?
- What are the likely costs and benefits of each approach?
- More importantly what are the challenges that regulators face in pursuing competition policy?
- How can a regulator best prepare for the transition towards greater reliance on competition policy?
The paper will draw on the understanding of how competition legislation works to identify the challenges that must be met in implementing competition policy within a postal setting. This will draw on case law both within the postal sector and other sectors to indicate some of the cost tests that are applied in the assessment of whether the conduct of a dominant firm is likely to be abusive. The paper will also examine whether such costs test are any different to *ex ante* price floors that could be set by a regulator.

The paper will draw upon recent examples in the UK, both within post and other sectors to show how regulators increasing use a ‘tool kit’ approach to regulation. Within this tool kit regulators not only choose between competition policy and sector specific regulation but also at measures aimed at consumer protection and raising customer awareness to enhance competition in the market place. In addition, as seen in the communications sector there is convergence in the method of assessment of effective competition and alleged abuses to ensure greater consistency in the outcome of regulatory interventions and to provide greater legal certainty for market participants.
The review of competition in the UK postal industry – agencies, polices and outcomes

John Baldwin, Stephen Bell, and Billy Hayes

The review of the impact of liberalisation upon Royal Mail has been concluded after an extensive consultation process. The review was notable because of the major policy debate that emerged from the evidence given by the various agencies in the postal market.

At the heart of the debate lay a conflict of policies varying from straightforward privatisation to proposals to utilise the state’s ownership of the industry to promote social as well as commercial goals.

From this struggle between agencies emerged apparently irreconcilable interests, ranging from those of bulk-mail posters to rural domestic customers; from a management team with a private sector background to a trade union with a loyalty to public service; and from a liberalising regulator to a Labour government.

In the course of the year’s campaign, the debate covered a variety of questions including the significance of a large pensions deficit; the advantages or otherwise of breaking up an integrated mails network; the value or problems of an industry specific regulator; whether the postal market is undergoing a long term decline or a cyclical recession; the role of the trade union in a changing industry; etc.

As the report is due for immediate publication, and contending agencies, and contested issues will now be forced to translate this rich debate into a coherent vision and policies for the future of the postal industry.

Written by participants in the debate, from a union perspective, the paper will attempt to demonstrate that while the events described are specific to the UK, there is much of significance here for those addressing the world market for postal services.

The paper will aim to locate union policy within the wider debate in society. The paper will be of interest to all those who require a serious study of postal regulation in the UK.
Abstract for the 17th Conference on Postal and Delivery Economics

Price cap regulation: The French experience

Bénédicte Bouin, Guillaume Lacroix
ARCEP

The law on regulation of postal activities was voted on the 20th of May 2005 by the French Parliament. This framework gave ARCEP (Postal Services and Electronic Communications Regulatory Authority) the responsibility for regulating universal postal service tariffs. ARCEP has therefore set up a price control system since 2006. As many postal regulators in European countries (Belgium, Germany, Italy, Portugal, United Kingdom, …), it was decided to implement a price cap mechanism which gives the Universal Service Provider a three years overview of its possible price variations in order to enable it to develop its tariff structure in line with Universal Service tariff principles. The first price cap framework was in effect for 2006 to 2008. In the beginning of this period, the postal sector anticipated mail decline. This new phenomenon led ARCEP to introduce the changes in the volume of postal items as a variable in the price cap mechanism; which represents a particularity of the French price cap.

This article will first present the particularities of the French 2006-2008 price cap mechanism in terms of scope, variables and adjustment mechanism. After that, the objective of this article will be to assess the situation after three years of application.

Based on this assessment and on the state of the postal market, ARCEP worked, during the second half of 2008, on the new framework which should be set up in January 2009. For the second price control, ARCEP introduced analyses on the tariff policy of La Poste and on the margins structure of its products. The second objective of this article will be to present how ARCEP modified the 2006-2008 price control and the debates raised by the introduction of a financial analysis; in particular, the level of cost knowledge needed and the view of the segmentation of the product’s family of the postal operator.
INDEPENDENT POSTAL UTILITY REGULATION: NECESSITY OR INUTILITY?

Carlos Costa, ANACOM

1. OBJECTIVES OF THE PAPER

Over the last few years, especially in the European Union, the discussion on the future of regulation within a post-liberalized environment has been very much focused on the paradigm of independent regulation (that is to say regulation delivered by national regulatory authorities, at arms length functionally from the undue influence of politics) following the lines mainly of the model implemented in the European regulatory framework for electronic communications and to a certain level in the energy utilities. The discussion has to a large extent neglected the theoretical background, including the literature on regulatory institutional design, and in general, has also not built upon empirical research on the degree of efficiency of the rare cases where entities akin to independent postal regulatory authorities have operated for sometime, even though, mostly, in a non fully liberalised environment.

In this context, this paper attempts to:

a. Contextualize the discussion of the actual need and design of postal independent regulatory authorities in the framework of the positive theory of regulation (especially at the light of the Chicago, Virginia, Toulouse and the Institutionalist/Contractualist Schools);

b. Analyse empirically the impact on consumer welfare of the performance of independent postal authorities, in cases where these entities have been functioning for sometime, in comparison to other EU countries.

2. APPROACH OF THE PAPER

This paper will rely on:

a. A thorough literature review and some theoretical developments regarding the grounds to support independent regulatory intervention in the postal sector;

b. The development of an econometric model, whose aim is to identify the specific impact of independent postal regulation over letter prices.

The existence or not of independent postal regulatory authorities will be treated as a “dummy” variable. Albeit it is difficult, in practical terms, to draw a clear line between “dependency” and “independency”, the information gathered by Niederprum et al (2006) regarding, inter alia, the designation/dismissal mechanism of the regulatory entity Board members, the length of the Board term, the relations between the regulatory entity, government and operators, the regulator’s enforcement powers, will help to define reasonable proxies for “independence”. The extensive literature available regarding the evaluation of the independence of regulatory authorities in the telecommunications field in conjunction with the authors experience in postal and telecommunications regulation will also reinforce this purpose.

As for the “control” variables, these will include, namely, the GDP per capita, GDP growth rate, postal traffic per capita, population density, broadband density (to account for some substitutability with mail traffic), country geography (the predominance of mountainous terrain or islands may be treated as a “dummy” variable), cost of labour,
literacy rate, income inequality, degree of the postal market concentration, quality of service levels and quality of governance. Most of these data are publicly available and should not prevent the timely completion of the paper.

3. ORIGINALITY OF THE CONTRIBUTION
The theory is not homogeneous regarding the objectives and ultimate interests of (“independent”) regulation, with four different schools of thought proposing different explanations.

The Chicago School follows an individualist and “libertarian” line of thought, based on the maximization of the utility of rational agents (Peltzman, 1989, 1976) and assumes that regulation is “captured”, frequently through a dynamic process over the life cycle of the regulator (Martimort, 1999), by the regulated entities (Bohem, 2007; Soares, 2007; Carpenter, 2004; Laffont and Tirole 1991; Stigler, 1971; Noll, 1999). Sometimes capture is achieved through personnel movements between operators and the regulators (Soares, 2007). Notwithstanding, under these assumptions, the equilibrium corresponds to a second best (Becker, 1983).

The Virginia School has its roots in the seminal works of Smith, Pigou and more recently in the works of Arrow (1951), Buchanan (1999), Leibenstein (1966), Olson (1965), Krueger (1974), Tollison (1982), and Tullock (2003, 1998, 1967). According to the Virginia School, regulation would be justifiable on the basis of market failures or undesirable social outcomes (e.g. natural monopolies or externalities), but it would be naive to presume that public agents act to maximize public welfare in the same fashion as private agents act to maximize private welfare. Moreover, public agents may act in a “rent seeking” fashion (Bhagwatti, 1998; Tullock, 2003, 1998, 1967; Krueger, 1974; Paul and Wilhite, 1990; Mixon et al, 1994; Benson, 2006) and that may encourage DUP (directly unproductive profit seeking) activities (Duso, 2005).

As for the Institutionalist and Contractualist School, one may devise its remote roots in Durkheim (1973) and Marx (1894), but its actual cornerstones must be credited to Coase (1937, 1960) and Williamson (1985). It may be considered a reaction to the formalism and automaticism of neoclassics and to the Austrian subjectivism, highlighting the role of institutions, habits and routines (Mair and Miller, 1991; Stiglitz, 2000) and exposing the limits of regulation due to information asymmetries (Akerlof, 1970), to ill defined property rights (Felder, 2001; Schwab, 1993) or to high transaction costs (Barzel, 1997).

Finally, the Toulouse School is related to the works of Laffont and Tirole (1993, 1991); Laffont, Rey and Tirole (2003, 1998); Laffont and Martimort (1999) and Tirole (2007). Its rationale goes back to the Austrian School, especially Mises (1963), but also Hayek, Rothbard, Morgenstern and Kirzner, according to which the inefficacy of regulation, heightened by “superfluous discoveries” arises from the lack of information of the regulator. It is also concerned with the institutional design of regulatory agencies, which has repercussions on the transaction costs and risks of capture.

This paper will attempt to discuss the implications of independent postal regulation in the framework of the above theoretical background, which, as noted earlier, has been to a large extent neglected in the present day discussion on the future of postal regulation.
in a fully liberalized environment. The study of the impact of an independent postal regulator on the price level, and thus on the consumer welfare, as devised here and considering its relations with the positive theory of regulation, represents also an original contribution.

4. PREVIOUS WORK, INTEREST AND TIMELINESS OF THE PAPER
No direct link to previous Conference papers were distinguished. This paper should be of interest to regulators, operators, government officials and consumer advocates, especially considering its public policy implications related to the forthcoming event of full market opening of the postal market in the European Union and its consequences and demands on the reshaping of the institutional design of regulatory authorities.

5. REFERENCES


Abstract for the 17th Conference on Postal and Delivery Economics

“The economic crisis as reinforcement of e-Substitution in the mail market”

P. Koppe, C. Bosch, S. Hömstreit, S. Pohl
Austrian Post / Marketmind

Although electronic communication was claimed to have a high impact on physical mail, the magnitude of actual substitution until now has been less than might have been expected. As mail volumes are influenced by a large number of factors, measuring the actual impact is difficult. However, changes in the communication market and electronic substitution (e-Substitution) play a major role in the consideration of Postal Operators (PO). Especially in Europe, the focus of the academic research as well of the POs had been on the full market opening in the last years. Changes in the market structures as forerunner of the liberalization make it difficult to get a clear view on the impact of electronic communication on the mail demand.

Recently two mega trends that affect most parts of the economic world started to exert major influence: The financial crisis and the increasing need for ecologically sensitive behaviour by industries and companies. Both have as well great impact on the use of electronic communication and the demand for mail.

As we showed in our paper for the 14th Conference on Postal and Delivery Economics, there is no general effect of e-Substitution on the mail-demand but a very complex pattern of different mail streams with diverging likelihoods of substitution (Koppe, BOSCH 2006). The summary of these mail streams facilitates to prove the causality of influences and measures to reduce mailing costs. This analysis showed that there is an adverse effect of economic situation and e-Substitution, as a company has to invest in alternative systems. The years of economic growth were used by many companies to introduce electronic communication systems. Therefore in the current crisis, one might expect a pressure on the mail demand.

The growing ecological alertness leads to the common view that electronic communication is in favour over physical mail. Together both trends make the anticipation that e-Substitution is becoming more important in the next few years.

On the other hand, studies show that for a big group of consumers the electronic communication is still missing an essential extent of convenience and security. These facts are important enough to revisit the topic in the current research.

Structure of the paper

After examining the general influencing factors of the communication market and the role of e-Substitution, we reflect the bulk of research to the topic and the gap to the actual situation. In the main part, we turn towards the perspectives of both market participants, the senders and the receivers:

− On the senders’ side, we deduce from the analyses of the different mails streams the impact of the actual forces on the implications of e-Substitution.
− Furthermore, the recipients’ opinions will be inspected as the acceptance of the customers is vital for a shift to another mode of communication. Qualitative and quantitative research in the past as well as a small survey which will be conducted in the next months show the requirements of private households to accept electronic communication as substitution of different mail types.
References


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Replacement of Letter Mail by Electronic Communications to the Year 2010, Heikki Nikali, 1995
Remittances and the role of Post Offices in the financial structure of economies

Neil Anderson - Head of Department UNI Post & Logistics Global Union
Stephen DeMatteo - US union, the National Association of Letter Carriers (NALC)

Objectives and Importance
The Universal Postal Union (UPU) has developed a secure and safe system for Post Offices throughout the world to use in the electronic transfer of money. The system offers major gains for migrant workers with lower fees and a safer and more secure way to transfer their money home to their families. It also offers the opportunity for Post Offices to run a more viable business model in developing countries and in rural and remote locations. In many rural and remote locations while there may be a post office, currently there is a financial exclusion with no banks or other financial institutions present for citizens to access. In the current world financial crisis there has also been a major increase in the use of Post Office Banks as people look for trusted “havens” with which to save their money.

Much work is being done to make the system developed by the UPU for the use of Post Offices to be a truly universally accepted mechanism for transferring money on a global basis. There is tremendous potential for growth in this work and for securing good secure postal worker jobs. According to the World Bank, global remittance flows increased by 118% between 2002 and 2007, rising from $US 116 billion to $US 251 billion. Given the average transfer is just $US 200, the number of individual remittance transactions is staggering.

Currently there are a number of problems for workers remitting money using existing methods. Often there is a high fixed transaction fee for senders, typically 13-20% of the transaction amount. There is also a low accessibility in rural areas, with families often having to travel long distances to collect funds, usually at a high cost. As many people are using informal remittance methods through unauthorized institutions such as money lenders and other insecure and untrustworthy agents, much of the money sent does not properly reach its destination.

Summary
This paper will outline the process of where governments, postal administrations and the World Bank have been concentrating their efforts and it will examine why a number of major Post Offices and their governments have been working to develop and promote the UPU system, currently known as IFS. It will also examine why to date that several countries, including many major countries such as the United States, have not signed on to the scheme. The paper will look the input by other international financial institutions such as the World Bank who see the advantages of having a proper financial system for remittances that eliminates graft and corruption, is safe and secure and delivers real benefits from migrant workers remitting their money to developing economies. It will examine that if the IFS system is to become truly universal the likely gains for the postal network and the gains for migrant workers and their families.

Methodology
The authors will be Neil Anderson, Head of Department UNI Post & Logistics Global Union, based in Nyon, Switzerland and Stephen DeMatteo of the US union, the National Association of Letter Carriers (NALC). They will analyse all of the statements and submissions presented by the UPU in describing and promoting the IFS system. It will also examine reports that have been commissioned by the World Bank on this issue and examine the proceeds of several
conferences, workshops and seminars on this subject by the World Bank, the UPU, postal administrations and governments such as France and La Poste’s efforts to develop the use of the postal network in Africa and the Spanish Government and Correos de España to develop links and the IFS system with Latin America and North Africa. The authors will evaluate the extent to which the gains for the postal network and the postal employees have been quantified and the current barriers to Postal Administrations in accessing and becoming part of this service.
ABSTRACT FOR CRRI 17th Conference on Postal and Delivery Economics, Bordeaux, France, 2009

Lessons from Postal Product Innovation
Submitted for consideration by L. A. Pintsov and A. Obrea (Pitney Bowes Inc.)

Pintsov and Obrea (2008) reported a conceptual framework for customer-driven product innovation based on Extensible Postal Product Model and Language (EPPML) standardized by the Universal Postal Union in 2009. O’Brien, Pintsov and Obrea (2009) further reported application of the EPPML framework to cost accounting for innovative products. However, many questions related to practical implementation of the EPPML framework in mailer’s and postal domains as well as reaction of postal operators to the new approach remain open. Besides, the 2008 papers by authors did not discuss in any detail significant practical examples of innovative postal products (both in letter and parcel mail categories) that could generate real demand among mailers and simultaneously can be effectively offered and delivered by postal operators using the EPPML framework.

The paper makes significant incremental contribution by addressing these and several other practical issues that are proven to be critical in discussions with postal operators and other potential users. The paper describes lessons learned as a result of practical implementation of the EPPML technology. Specifically, it defines and explains organization and use of tools conceived to assist postal product designers. These tools include an EPPML editor enabling simple, user-friendly interface to most complex of EPPML features. The paper also addresses mailer experience when mailers are facing a need to select and purchase sophisticated new products with complex access requirements. Authors have multiple discussions concerning implementation of effective product innovation with postal operators worldwide. The paper describes obstacles posed by postal infrastructure optimized for delivery of relatively few well known and understood postal products.

Features of the EPPML approach that are particularly difficult to achieve with traditional methods of product definition and implementation are highlighted. These include, for example, exception handlings and complex product offering constraints designed to allow for maximum flexibility in defining features of the product. The discussion is linked explicitly to product innovation strategies and illustrated with several examples of innovative products having various desirable features. Specifically, these include “mutually trusted mail”, “mail with provable content” and “vote by mail” products.

References

UPU Web site:
http://www.upu.int/pls/ap/Organ_View.Sub_Bodies_Tree?p_id_organ=615&p_language=an

Applicable conference topics:
- Future Technologies
- New products and services
Sustainable development and postal sector
François Boldron and Christelle Defaye-Geneste
Groupe La Poste

The postal sector, and more particularly the European postal sector, has been confronted with two major changes in the last few years. First, the progressive liberalisation of the markets. Second, the emergence and development of electronic substitutes to mail. The consequences and challenges they imply have constraint postal operators to re-think their strategies and organisation. Several works have been done on these topics. Some of them were presented during previous Rutgers conferences. However, a third phenomenon that could also deeply modify the postal sector has hardly been touched upon by the community of postal economists - the environmental impact of the postal sector. These questions will necessarily impact the demand (paper) as well as the cost structure and level (reduction of greenhouse gases emissions).

In order to anticipate the potential impact of sustainability on postal operators, a first step will consist in a precise analysis of the legal environment of the operators. Several EU texts constrain and/or guide companies’ strategies. As an example, the activities of postal operators largely rely on transport operations, particularly air and road transport, which cause great CO2 emissions. The ongoing negotiations on the Climate/Energy Package are based on a reduction of CO2 emissions by 20% by 2020 (compared to 1990 levels). Transport activities of public postal operators could also be impacted by legal requirements. As an example, the European Union is seeking to develop markets for clean vehicles through public procurement by imposing “green requirements”. Operational lifetime costs of energy consumption, CO2 emissions, and pollutant emissions will be included as award criteria for all procurement of road transport vehicles by public authorities or operators covered by directives 2004/17/EC and 2004/18/EC. Another example: postal operators are often large building owners. The European Union is reinforcing its requirements in terms of energy efficiency of buildings. These three examples are only an illustration of the diversity of the EU environment law that can impact the European postal sector.

In a second part, the article will present how La Poste is adapting to these new pieces of legislation but also how it has adopted a corporate social responsibility scheme. La Poste is engaged in a responsible development policy building on three pillars. A social pillar (diversity, increased quality of jobs…), a societal pillar (new territorial dynamics, participation of La Poste employees to solidarity actions…) and an environmental pillar (reduction of CO2 emissions, sustainable paper policy…)

In the third and last section, we will study the economists’ view on firms that adopt corporate social responsibility scheme (demand incentives, strategic behaviour, altruism…) and we will address the crucial issues postal economists will have to answer. In particular, we will highlight the difficulties that could arise when firms adopt such ‘green’ behaviours: the « greenwashing » phenomena, the potential gap between (uninformed) consumers expectations and social needs, the absence of tools or cost-benefit analysis to define the most efficient way (in terms of financial cost) to reduce CO2 emissions.

1 The papers by J. Berenblatt, L. Buc & Peter Soyka and by L. Jimenez, J. Auslander & D. Koljonen presented last year in Albufeira are, as far as we know, the first ones in this area.
A Comparison of the Carbon Footprint of Mail and Electronic Communications

Luis A. Jimenez

The environmental impact of mail has been estimated in a number of efforts. A PostEurop taskforce estimated the carbon dioxide (CO2) impact of posts across Europe at between 8 and 11 million tons (Persson, 2008). Estimates from 14 available studies of the posts’ emissions inside the postal value chain and calculated on a per-letter basis were summarized in Pitney Bowes, 2008 and Jimenez, 2008b and 2008c. These authors also reported on an “indicative range” of emissions upstream of the postal value chain, from the harvesting of wood, through the manufacture of paper, the creation of a printed mail piece and its insertion into the postal system. Bank of America (Berenblatt, 2008 and Buc and Soyka, 2008) have described efforts to estimate carbon footprint across some of the company’s activities. The USPS Greening of the Mail Taskforce has been developing an independent analysis (USPS, 2008). Finally, the Aspen Initiative for the International Mailing Industry has begun an effort to perform a full-scale Life Cycle Impact Analysis for letters (Fava, 2008).

Awareness of the range of CO2 emissions generated inside the postal value chain and in the upstream creation of mailpieces is helpful to policymakers when developing targets and programs to reduce emissions generated from the use of mail. PostEurop (2008) has set collective reduction targets for its members and IPC (2008) has established a carbon measurement protocol. However, a comparison between the use of paper and electronic communications is needed for users who wish to make informed choices between these two methods of communication based on their environmental preferences. To date, this comparison has not been available to the mailing, computer and communications industries, much less to individual mail and computer users. A number of methodological issues that arise when estimating the environmental impact of communications are discussed by Jimenez (2008a). Two issues of particular interest are: (1) how to draw an appropriate “boundary line” for the analysis, and (2) how to allocate total system emissions to functional units.

This paper will address these two issues and develop estimates of total CO2 impacts for both mail and electronic communications. It will also develop measures that are comparable for the two media by selecting appropriate functional units, such as per person, per day of communications activity and per transaction. The paper will also indicate what further research is needed in order to develop more refined comparisons between paper and electronic communications.

REFERENCES:


USPS (2008), Life Cycle Inventory of Mail, presentation by Michael Fanning


USPS (2008), Life Cycle Inventory of Mail, presentation by Michael Fanning


\(^{1}\) Luis Jimenez is Managing Director of Luis Jimenez Consulting. Howard Wright is Managing Director of insight2foresight.
Abstract: Life Cycle Inventory of Mail in the United States

Authors: Lawrence G. Buc, Peter A. Soyka, and Sander Glick (SLS Consulting Inc.)

The environmental aspects of mail are increasingly under scrutiny, particularly from "green" and "Do Not Mail" interest groups. Despite the significant attention being devoted to the environmental impacts of mail, to date there has been no published reliable, comprehensive study providing the life cycle inventory of mail.

To remedy this gap and provide information for policy analysis and a fact-based debate, the United States Postal Service sponsored a life cycle inventory of the mail. Specifically, for the mail classes comprising 98 percent of the US mail volume, we estimate generation and emissions of eight pollutants (solid waste generation, carbon dioxide, carbon monoxide, dissolved solids, hydrocarbons, nitrogen oxides, particulate matter, and sulfur oxides) through nine stages of the life cycle of mail, spanning the entire supply chain from the harvesting of trees to make paper through the ultimate disposition of the mail through either recovery or disposal in landfills or incinerators. The analysis has been prepared in accordance with relevant international consensus (ISO) Standards.

This paper describes the methods used to perform the analysis and presents the results. It also discusses an important methodological issue that is almost never addressed in the life cycle analysis literature: how emissions actually respond to volume changes in the product(s) being addressed and how they should be allocated in the case of joint production. This issue is of critical importance to policy analysis if the option "produce (or consume) less" is under consideration. The paper illustrates how treating shared resources and related pollutant emissions appropriately yields results that are robust, consistent with international standards, and useful to the formulation of public policy.
Some Dynamic Models for Mail Demand: the French case

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S. Lécou (La Poste – France)

Abstract

This paper deals with an empirical analysis of the mail demand for the French postal services. More precisely we estimate dynamic demand models in order to identify links between mail demand and some economic variables, and to assess price elasticities.

Two major events took place during the last decade that could have an impact on mail demand. First of all, the regulatory environment has changed with the transposition of the 2002 European directive. In France as in many countries in Europe, the reserved area has been reduced progressively to at least letters below 100g in 2003 and below 50g in 2006. The introduction of competition leads usually to significant changes on demand due to the greater choice of products for consumers, new tariff structure, or innovation on product portfolio offered by firms. Secondly, we observed a deeper penetration of information technology in business processes and a large diffusion of broadband internet access for households. These two simultaneous trends act on the “business to customers” activities, especially those related to the customer relation management and the corresponding marketing strategies.

Facing the new legal environment and the development of electronic substitutes, it is useful to update the results previously obtained by Florens, Marcy and Toledano (2002) using yearly data from 1969 to 1999, and to draw some issues for the postal sector. In particular, because price elasticities are useful for regulatory decisions or competition law case as they could be used to define relevant market or to determine market power.

To analyse the impact of these changes on mail demand, two different data sets on mail volumes and prices are considered. One is on a quarterly basis between 1996 and 2005 and gives information about turnover and mail volumes for 3 types of mail (first class, second class and direct mail) and 2 types of senders (households and firms). The other data set is on a yearly basis, between 1969 and 2005, and gives information about volumes and prices for first class and second class mail below 20g. We use these data to estimate some dynamic econometric demand models in which we consider mail volumes or turnovers according to available information.
Forecasting Mail Volumes in an Evolving Market Environment
Frédérique Fève (IDEI-TSE), Jean-Pierre Florens (IDEI-TSE), Frank Rodriguez (Royal Mail Group) and Soterios Soteri (Royal Mail Group)

The opening of mail markets to competition is progressing at varying speeds in many industrial economies. Evidence to date indicates that competition in postal markets is dynamic in nature and may take a considerable time to develop fully (see for example Cohen et al 2005 and Dudley et al 2008). The aim of this paper is to develop a stylised theoretical framework to provide insights into the complex problem of projecting the demand for mail during a period when the market is evolving from monopoly to competition, as well as there being major changes to the underlying demand for mail due to technological substitution.

The uncertainty associated with forecasting total mail demand in a stable market environment can be considerable (see Cazals et al 2008). In an environment where policymakers are opening up the mail market to competition and factors such as advances in technology and macroeconomic uncertainty are affecting the demand for mail, forecasting mail volumes becomes significantly more difficult.

The theoretical framework developed is Bayesian in character. It explores explicitly such uncertainties and examines the extent to which these could be reduced through the use of business information and survey data. As part of this forecasting framework, the paper will consider the construction of mail market and firm level projections in an environment, where, at least initially there may be very limited observable historic data. It also considers the structured updating of projections and model assumptions as new information becomes available over time regarding the evolving market environment. In particular, the theoretical framework assumes that assumptions are updated in the light of partial observations using a Bayesian version of the Kalman filter approach and results are illustrated via simulation analysis.
References:
The topic of customer satisfaction (CS) evolved in the management theory during the Quality management boom in early 1990, and accompanied later with Balanced Scorecard and CRM philosophies in the early 2000 years, it has become one of the systematic ways to integrate customer needs into the improvement and development processes of companies.

Postal business and demand of services are very much impacted by the top 30-50 customers through their large volumes - so customer satisfaction at a customer level, and customer segment level are important elements of business development.

Itella, former Finland Post has systematically researched customer satisfaction since 1993. This paper describes the current CS research system among Itella business customers - both how the surveys are done, and how the content of the surveys are modelled and analysed. There is also a description of the utilization process - how, when and by whom the results are or should be utilized in the organisation.

This paper also reviews the development of analysis methods – from gap analysis to structural equation modelling, and presents current models of business customer satisfaction. Most CS-models include the evaluation of operative areas together with brand and price attributes, leading to customer loyalty, and aim to find out strengths to keep and to update, and weaknesses and areas to be improved to being competitive in the customers’ viewpoint. This paper discusses the usefulness of customer loyalty as an ultimate consequence of customer satisfaction – especially in the postal market and in terms of our CS data. It also underlines the need to integrate data from the operational systems (such as sales and invoicing) to the survey data, in order to get proper understanding and actionable conclusions for the business development. So the basic approach of this paper is combining theory and practise – doing CS research that produces reliable, valid and relevant results to be utilized in order to improve business performance.

The paper aims to share Itella´s experience of a long term CS research programme. The topic of CS is not so often discussed in the earlier conference papers, so this one will be of interest to researchers, managers and development people of postal, delivery and carrier organisations, as well as research suppliers and developers of research methods in the academic area. Also the Postal regulators are interested in customer satisfaction –in many countries they do nowadays their own satisfaction studies among postal customers.
The Cost of a Uniform Price Rule in a Liberalized Environment

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A consensus has emerged that the theoretically preferred approach to measuring the cost of a universal service obligation for a postal operator is the profitability approach. In this approach, the net financial position of the postal operator is calculated both with and without the universal service obligation in place. The difference in net financial position caused by the imposition of the obligation is the profitability measure of its cost.

This approach has several advantages. First, the approach can be applied whether or not the postal environment is liberalized. This means that the profitability approach can be used to explore the relationship between the universal service obligation and the postal monopoly or “reserved area.” Second, the profitability approach includes both cost and demand responses to changes in the universal service obligation. Third, the profitability approach is general, so it can be used to investigate different aspects of the universal service obligations such as delivery day requirements or uniform pricing rules.

Despite its theoretical advantages, the profitability approach has rarely been implemented, primarily because its data and computational requirements can be quite high. Not only does it require detailed data on a postal operator’s costs and revenues, it also requires specifying how both the postal operator and actual and potential entrants would respond to relaxation of the universal service obligation.

For example, consider calculating the cost of a uniform price component of a universal service obligation. Under uniform pricing, the post must charge the same price for delivery to all areas of the country. In a liberalized environment, this
competitive restriction reduces the postal operator’s ability to respond to competition and thus erodes its net financial position. Calculating the cost of the USO thus requires computation of the volumes revenues and costs generated by the postal operator, both with and without the uniform pricing restriction.

Such a computation requires identifying where competitors would enter the postal market, the degree of entry, the price at which entry occurs and the amount of volume diverted. It also requires identifying those areas of the country in which the postal operator would respond to competition, when allowed, and a calculation of the financial impact of that response. A postal operator would respond to competition only when that response would increase profits.

In this paper, we build and employ a detailed quantitative model for calculating the cost of universal service for the United States Postal Service. The model is constructed at the 3-digit ZIP Code level, and thus analyzes entry and the Postal Service response to that entry at over 900 individual 3-digit ZIP Codes. It incorporates profit maximizing behavior by actual and potential competitors and is based upon current Postal Service volumes and costs at the 3-digit ZIP Code level. We use the model to analyze the impact of a relaxation of the Private Express statutes and the mailbox rule on Postal Service volumes, revenues and costs. We then employ the profitability approach to calculate the cost of the uniform price aspect of the Postal Service’s universal price obligation.
Would the real cost of universal service provision please stand up?
A calibrated approach to universal service costing and financing

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Abstract
The financing of universal service provision in the postal sector has traditionally relied on granting the provider a reserved area. Together with increased electronic substitution, current liberalization policies promoting competitive entry may put the traditional universal service at risk. The need for alternative funding sources has increased the interest of regulators and the public in knowing the cost of universal service provision. The interest in universal service costing is twofold:

- First, the universal service provider should be correctly compensated for its burden. This implies knowing its private cost, as e.g. measured by the well known profitability cost approach. Annex I of the 3rd Postal Directive (2008/6/EC) provides guidance on how to calculate the “net cost of universal service obligations”.
- Second, the definition of the scope of universal service should be based on the knowledge of its costs and benefits. This implies knowing the public cost, taking into account changes in all competitors’ profits and consumer surplus due to the universal service obligation and its financing.

We start from the profitability cost approach pioneered by Panzar (2000) and Cremer et al. (2000). The approach has basically been adopted by the 3rd Postal Directive. A number of contributions have treated universal service costing and financing separately. Only recently it has been argued that the market structure and the actual cost/burden of USO are directly related to regulation and the funding mechanism in place.

Based on the modeling approach by Valletti et al. (2002), we develop a calibrated model to analyze the interaction between the private and social cost of universal service provision and its financing. Potential funding mechanisms include a compensation fund, state funding and a pay-or-play mechanism. We then derive and discuss the competitive and welfare effects of these funding mechanisms.

The subject is timely as the Member States of the European Union are currently implementing the 3rd Directive in their national legislations. As there seems to be no common understanding about how to finance the net costs as prescribed by the Directive, we hope to provide some valuable contribution to the discussion.
References


WELFARE AND COST FOR CHANGES IN SERVICE SPECIFICATION
WITHIN THE UNIVERSAL SERVICE

Philippe De Donder¹, Helmut Cremer¹, Paul Dudley² and Frank
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The universal service provider (USP) is required under the European Postal Services Directive (2000) to provide universal services of collection and delivery for a minimum of 5 days per week across the nation, and at prices that are affordable and may be geographically uniform. In some countries the service specification exceeds this minimum requirement and this has raised a question as to the economic appraisal of reducing the service specification to the minimum level.

In the presence of significant economies of scale and fixed network costs and declining addressed mail volumes, the financial position of the USPs has the potential to deteriorate. European Postal Services Directive provides the scope for a compensation fund or other payment mechanisms to support the universal service in the event that certain conditions are met. Those conditions relate to the potential reduced burden to the USP arising from the reduction or removal of the minimum service specification of the universal service.

The common feature of these two areas of the specifications of the universal service and of funding mechanisms is the economic appraisal of changes to the service specification and requirements placed upon USPs. Analysis and appraisal of related subjects have been looked at in the literature. Included here are approaches to the financeability of the USPs (Crew and Kleindorfer, 2000); profitability of the USPs (Cremer et al 2000; Panzar 2001); the analysis of assessing the impact of the uniform tariff constraint of the universal service (De Donder et al, 2001, 2002); calculations of net cost of changing the service specification (Burns et al, 2008); calculations of the cost of the universal service provision (Trinkner et al, 2008); and the regulatory implications of changes in service quality (Crew and Kleindorfer, 2008).

Building on this earlier literature this paper seeks to set out a conceptual economic framework for the assessment of changes to the service specification, and related matters, of the USP, with a view to providing further insight for the two current areas of interest set out above. We proceed by developing an analytical framework, related to welfare and costs, for consideration of these issues and draw insights to policy considerations in these areas.
Abstract

Changing Postal Environments and the Impact on Marginal Cost

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This paper will isolate the implications of scale and efficiency effects. The traditional telecommunications literature on productivity going back to the 80s looked at scale effects and efficiency effects. These effects were based on the assumption of volume growth. Costs fell because of increasing volume - the scale effect - and fell again because of increasing technological change - the efficiency effect. The attempt was to set the X factor so that the firm, AT&T did not benefit from the scale effect. We are looking at the process in reverse. The USPS is experiencing a scale effect resulting from volume drop. This pushes up average costs. It is also experiencing an efficiency effect, which is working in the opposite direction. Our paper will lend insight into the relative size of scale versus efficiency effects on average cost as volume drops but efficiency increases simultaneously. The two effects are summarized below:

Volume effect: These are changes in marginal cost due to changes in the volume of a product. In particular, as mail volume decreases, average cost will increase as scale effects work in the opposite direction as volume declines.

Efficiency effect: These are changes in costs due to changes in the production and distribution processes, i.e. as automation and network realignment increases, costs will decrease as excess capacity in production and distribution declines.

In this paper we will be using U.S. Postal Service mail processing plant data for the entire United States, we will calculate plant level average cost on both a quarterly and an annual basis. Preliminary results reveal a wide variation in average cost among plants. Further analysis is currently underway to correlate these average costs with changes in volume and efficiency. In this manner, we plan to develop a method for determining what factors are impacting average cost and the appropriate response to these factors. For example, what level of efficiency increases will offset volume decreases, and vice versa.
This work has implications for postal operators that are experiencing declining volumes and/or have inefficient infrastructure. By isolating the impacts of volume decline and efficiency changes on average costs, more effective and forward looking solutions for problems facing posts, such as operational inefficiencies, excess capacity, and decreasing demand, may be found.

References:


Economies of Scale and Scope in the Swiss Post Office Network

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Abstract

The purpose of this study is to analyze the cost structure of a sample of Swiss post office network in order to assess economies of scale and scope and, therefore, to define the optimal size of the firms in this sector.

For this purpose we specify the following cost model:

\[ TC = f(P_C, Q_1, Q_2, Q_3, Q_4, Q_5, OH, BM, UA) \]  

where \( TC \) represents total cost and \((Q_1 - Q_5)\) are the outputs measured by: collected letters and parcels, payment services, account management and the sale of additional products. \( OH \) is a variable representing the opening hours of these offices. This variable can be interpreted as an output characteristic variable. \( P_C \) is the prices of capital. The variables \( UA \) (urban area) and \( BM \) (business model) are introduced in the model as “environmental” characteristics.

The estimation of cost function (1) requires the specification of a functional form. The translog cost function offers an appropriate functional form for answering questions about economies of scale. For comparison purpose we also use a log-log functional form.

The study is based on a data set for the year 2006 with information on 2350 post offices and 120 agencies operating in Switzerland.

The novelties of this paper are two. First, we include opening hours in the cost model specification. This variable will allow us to consider in the production process situations where an office has to remain open also if the demand is zero. Second, the Swiss Post’s collection units are characterized by a strong observed and unobserved heterogeneity of the environmental and production situation. This unobserved heterogeneity could create some econometric problems. In order to take into account the unobserved firm-specific heterogeneity we use a latent class model.
Following ARCEP’s request in its decision n° 2008-0165 concerning cost accounting (February 2008), La Poste has undertaken a study on the influence of size and weight of items on costs of manual processes for handling mail. This analysis is crucial in understanding and evaluating cost drivers in postal processes. The scope of the study involves 3 processes: manual sorting, in-offices processes for delivery, and the loading part of the outside delivery process.

The cost accounting model is basically a top down allocation of costs, based on ABC principles. The costs of each process are given via cost accounting information systems, and, if relevant, separated by sub-processes, so-called “economic processes”. Costs are then attributed to products via cost drivers. This requires an engineering analysis of the subcategories driving costs, and a quantitative valuation of the drivers. Each product is then represented by a particular combination of the drivers. The objective of this paper is to present the methodology including assumptions and simplifications, for valuating cost drivers, and quantitative results.

The traffic is classified in four categories: (1) “small format” which designates mail below 50 grams, (2) “large format”, which is mail between 50 grams and 250 grams, and two categories of “encombrant”, which is flows (mail or parcels) beyond 250 grams, (3) with a maximum thickness of 2cm, and (4) thicker than 2cm. As in Cazals et al (2001), we are presenting the cost drivers in an index model: the value of “small format” is always 1 by construction, and each other category reflects the gap relative to the small format category.

The paper describes in the first section the methodology adopted. The study has been carried out by creating a “laboratory”. 30 Postmen have been time-measured when handling 30 lots of mail, each lot being composed by a specific proportion of the four categories of flows. The assumption is made that the indexes, reflecting the relative difficulty for handling mail, should be comparable from one postman to another, even though some can be globally more efficient than others. About 60,000 items were handled for the experiment. In the second section, we give a description of each process and sub-processes, and present quantitative results of the drivers.
This paper introduces a methodology for valuing the postal letter monopoly and the (United States) mailbox monopoly that is closely related to the profitability method of valuing the USO. It also presents a model that calculates the value of the monopolies in the United States. Empirical results are presented for the cost of the USO that focuses on its largest element - frequency of delivery. That result is driven primarily by the fixed cost of delivery. The paper explores the role of the fixed cost of delivery in the model used to value the monopoly. It also examines the value of the letter monopoly and its relation to the volume per capita of a post. In addition, the model examines the effect of flexible pricing on the value of the incumbent’s monopoly.

The model makes use of data on all USPS evaluated rural routes (97 percent of rural routes) and on a ten percent sample of city routes. The data includes the volume of mail (by shape for rural routes and by subclass for city routes) that is being delivered on the day the data is recorded.

This paper extends the USO costing methodology developed in John Panzer’s paper, “Funding Universal Service Obligations: The Costs of Liberalization.” It also relies on the entry pricing model that was developed for a paper by Cohen et al. “An empirical Analysis of the Graveyard Spiral.”

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2 Ibid.
The full market opening in 2011 (resp 2013) rises the question of financing or sharing USO in the absence of monopoly. This problem is more or less crucial according the cost of universal service per se, but also regarding the contestability of the market. A high net cost of universal service may not necessarily represent an unfair burden, if competition is only in its earliest stages, and if the incumbent enjoys a reasonable profit (see Boldron, Borsenberger et al., 2008).

The objective of this paper is to give indications of the net costs of universal service over Europe and USA, by studying counterfactual scenarios when relaxing three components of the US constraints in the postal sector: the obligation of delivering at a certain frequency, the accessibility of the counters, and the “affordability” constraint. Following the analysis started in Ambrosini et al. and followed by Boldron et al, we generalize the approach of studying the gap between the actual situation (so called the reference scenario) vs a unconstrained behaviour (the counterfactual scenario). We compare normalized financial gains in various countries in Europe and USA when reducing the number of deliveries in rural areas, reducing the size of the counter network to a commercial size, and cover the costs of unprofitable flows, if relevant after these process adaptations. The first part explains the assumptions of the counterfactual, and explains why and how the process constraints could be relaxed in a commercial behaviour. A second part presents how the model works in each case, using public geographic and market data. The third part of the paper presents the result for the three major components of the US constraints (delivery, counters, and affordability) in each considered country, and all caveats of the results.

1 The opinion expressed in this paper are the ones of the authors, and do not reflects the position of La Poste
Tendering Universal Service Obligations in Liberalized Postal Markets

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Recent liberalization of network industries reveal the low profitability of postal services in rural and remote areas. In a liberalized market, firms enter in low-cost – usually urban – areas, but are not interested in investing in rural areas. In order to solve this problem, many countries complement liberalization with universal service policies which guarantee that all citizens have access to certain services with a minimum quality at an affordable price.

One type of universal service financing consists of subsidizing the provision of the service in rural areas. Reverse auctions might be a useful mechanism when there are several firms interested in providing universal services in unprofitable areas. In such an auction, various operators submit bids for the subsidy they would require to offer services in such an area. The winner of the tender is the operator that asks for the smallest subsidy. In turn, the operator needs to comply with the requested universal service obligation (USO) regulations (coverage, services, price, quality). Such auctions can be organized by a regulator in a liberalized market or by an incumbent operator aiming at contracting out the collection and distribution of letters in selected regions.

Postal markets are in general good candidates for the application of reverse auctions, since sunk costs are relatively moderate and quality characteristics are easily observable. However, unlike reverse auctions in other industries, tendering USO obligations in the postal sector exhibits two main differences.

(1) The USO will likely not be defined differently in remote and dense areas. Hence, if there is a uniform pricing constraint on universal services, regional markets are linked. Input regulations concerning the collection network cause additional interdependencies. Therefore, auctioning the provision of universal services in different regions separately induces complex optimization problems, as from an operator’s point of view, winning an auction has cross effects on services offered in other areas.

(2) In the postal sector, winning an auction might not involve exclusive rights. For example, it will not be possible in the EC to organize competition for the market (i.e. auction of a bundle of monopoly rights and USO) as monopolies will no longer be allowed. Winning such an auction therefore adds significantly to the risk taken by potential universal service providers as they have to take into account the future development of competition when bidding. Those outcomes are uncertain whereas the winner of the auction faces
strictly defined ex ante USO regulations for the duration of the contract. In the winner’s view, this translates into foregoing the option to adapt its business model to the current needs of competition. Hence, auctioning introduces additional social cost to providing universal services that can be modeled by use of real options theory.

The objective of this paper is twofold: First to analyze the possibility of using reverse auctions for allocating universal service obligations (USO) to postal operators. The second objective is a formal analysis of the fundamental differences between competition for the market (tendering USO based on reserved areas) and competition in the market (tendering USO in an otherwise competitive market).

The paper is organized as follows. First, we briefly review several USO auctions that have been undertaken in various countries in the telecommunications, electricity and air transport sector. We describe successes and failures and discuss the main challenges resulting from reverse auctions. The second section assesses the most relevant features of USO auctions. The first and most important challenge in tendering an universal service obligation is to define the obligation itself with respect to scope, quality, pricing, duration, and its relation to other services. We compare reverse auctions with other mechanisms that can be used to select the USO provider, such as direct negotiations or beauty contests, where the regulator chooses the USO provider, taking into account not only the price and the coverage offered by the firm, but also several “soft” factors. Moreover, we discuss the introduction of competition for a market vs. competition in the market. Finally, the third part of paper assesses the main challenges generated by the use of reverse auctions in the postal sector. Besides (1) and (2) the use of auctions implies further challenges for the regulator (e.g. selection of services reserved to USO operators, regulation of retail and access prices in the areas auctioned, detailed ex ante quality regulation, etc.) and for the operators (e.g. calculating the net cost of USO).

The paper complements previous studies by Borrmann (2004), Jaag and Trinkner (2008) and WIK (2008) with international experience in other industries and expand it by a stylized formal model to elaborate on the key issues.

We believe that such a discussion is now a timely and important matter, as postal market opening brings along new challenges in defining, allocating and financing universal services. Auctions might be an efficient instrument to regulate postal markets and have been successfully introduced in other network industries, such as the telecommunications and electricity.

Bibliography


THE EFFECT OF FALLING VOLUMES ON TRADITIONAL EFFICIENCY ASSESSMENT

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ABSTRACT

Differently from other regulated sectors, post has experienced falling output in the recent past. With the advent of the current recession, the fall in postal volumes is expected to accelerate. As many studies have shown, postal operators enjoy economies of density, which in theory should imply a more-than proportional fall in costs as volumes decline. However, economies of density measured using cross-sectional or panel data over periods of volume growth may be problematic: whilst it is true that an increase in volume yields a less-than proportional increase in costs, the reverse may not be true. In other words, the relationship between costs and volumes may not be symmetrical. This is especially true of labour costs, representing a relevant proportion of total costs: many postal operators are characterised by a heavily unionised labour force, and find it hard to remove costs from the business as volumes fall. This represents an external constraint on postal operators’ ability to minimise costs.

Traditionally, cost efficiency has been assessed using cost models that do not take into account the effect of past volumes on current costs, i.e. what has become to be known as the “pace of marginality”. Efficiency targets have been set using these models. In this paper, using simulation techniques, we will analyse the impact of ignoring the pace of marginality when estimating cost efficiency, and the consequent attainability of efficiency targets set in a traditional in postal market that are experiencing relevant falls in volumes.
A natural operational measure of the cost of universal service for an enterprise with a sub-modular cost function is the maximum cross-subsidy for any subset of subsidized products caused by pricing the enterprise's products subject to the conditions imposed by the universal service obligation (USO). This measure is supported by recent research showing that the smallest subset of services maximizing the cross-subsidy includes all of the enterprise's products that are responsible for all cross-subsidies, and excludes all of the products that are not responsible. In addition it is often possible to identify the subset of subsidized products and to calculate the maximum cross-subsidy by applying a simple myopic algorithm.

"Universal service" is an elastic concept whose varying definitions would certainly include the U.S. postal system's geographically averaged rates and uniform standard of delivery service for most categories of mail. Furthermore, the cost functions used by the U.S Postal Service (USPS) and the U.S. Postal Rate Commission (PRC) for postal cost accounting are strongly sub-modular due to large economies of scope and scale in delivery and the presence of location-specific fixed costs. Therefore, the maximum cross-subsidy is a measure of the aggregate transfer of value that occurs across U.S. postal customers as the result of geographically uniform postal rates and services.

In this paper we present estimates of the maximum cross-subsidy for several recent postal fiscal years. In addition we identify and characterize the properties of the regions of the U.S. that are the apparent beneficiaries of the cross-subsidies. To make our measurements we treat postal services for different geographic areas as distinct "products". So a cross-subsidy corresponds to a transfer of the same value among postal customers sending mail to different regions. Our estimates are derived by applying the myopic algorithm to a geographic decomposition of the postal cost function. We also make use of additional data describing operations and costs at local levels as reported by USPS to the PRC.

Our measure of the cost of universal service differs from one advocated by Panzar. Panzar proposes a comparative statics exercise from which the cost of universal service is derived as the difference in the revenue needed to cover "institutional" costs before and after the elimination of the USO. While this measure makes excellent sense within the context of a specific proposal for ending the USO, it is much less attractive as a basis for defining a measure of the cost of the USO that is both general and operational. Under Panzar’s proposal the cost of the USO depends upon a “careful specification of an unsubsidized market scenario that would prevail in the absence of the USO”. Panzar’s definition leads to different formulas and different measurements for a regulated monopoly, an unregulated monopoly, competition with a reserved service, without a reserved service, et cetera.

The “unsubsidized market scenario” that resides behind our measure is the same “scenario” that is used to measure incremental and stand-alone costs. It assumes that subsidized services are deleted from the postal enterprise’s product offerings while prices and demands for the remaining services are left unchanged. This is entirely improbable

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and uninteresting as an assumed market scenario, however, the assumption has the singular advantage that it leads to an operational measure of the cost of the USO that corresponds to a well-defined cross-subsidy. Our measure is equal to the aggregate value exchanged by postal customers as a result of the USO when they purchase postal services at given prices. Furthermore, this cost of the USO is fixed with respect to postal prices and demands. The measurement is the same, as it should be, no matter how one goes about conceptually eliminating the USO.
WHAT IS A WELL RUN TYPICAL UNDERTAKING IN THE POSTAL SECTOR?

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On July 24th 2003, the European Court of Justice (ECJ) through the Altmark ruling defined the four conditions so that a compensation for public services is not considered state aid:

1- The recipient undertaking must actually have public service obligations to discharge and those obligations must be clearly defined;
2- The parameters on the basis of which the compensation is calculated must be established both in advance and in an objective and transparent manner;
3- The compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of the public service obligations, taking into account the relevant receipts and a reasonable profit;
4- Where the undertaking is not chosen in a public procurement procedure, the level of compensation must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations.

Till now in all European regulated industries had to show that they incurred costs necessary for providing the service (Hansen et. al, 2003). The ECJ decision applies directly to urban transport public undertakings, but quickly become a milestone for evaluating whether a public subsidies complies with competition rules on State Aid (Travers, 2003). Postal services are an obvious candidate, since some of the European Postal Administrations get a subsidy from the State for fulfilling universal service obligations (Fratini and Filpo, 2006). However the European Commission (2008) to fully consider such a subsidy as a non state aid requires a fulfilment of all four Altmark criteria, including to demonstrate that beneficiary’s costs for providing the public service obligations are those of a typical well run undertaking.

The paper discusses the problems arising on the application of the fourth condition of the Altmark ruling, requiring that compensation, if not assigned by public procurement procedure, needs to be determined by benchmarking the operations of the public service provider against market determined standards.

It has been observed that such a fulfilment is uneasy (Koenig and Haratsch, 2003), for at least three reasons. The first is that efficient costs of a monopoly are by definition the observed costs if no other firms operating under similar conditions in other geographical markets can be taken as a benchmark. This is reasonable since USO are not a normal good supplied on the market, but rather a mixed good, rather peculiar for each country, that includes private and merit good characters (Gori, Lettieri, Marè and Visco Comandini, 2002). The second reason is that if there are
only few potential providers of a certain service, a tender or even a survey of typical costs would not prove very useful (Santamato and Pesaresi, 2004). The third reason is that if an industry, charged with USO like postal services, exhibits significant economies of scale, especially in delivery (Cohen et al, 2002; 2004; PWC, 2006; Cohen 2008; Cohen and McBride, 2008), postal administration operating at a low scale (low per capita volumes) face higher unit costs than those with high volumes. As a consequence, a simple comparison of the efficiency of a specific postal administration firm with averaged values of the other postal administrations – a naïve interpretation of Altmark’s ruling – is very likely to be biased toward those operators enjoying large economies of scale.

As far as market liberalization goes on in Europe, postal USO financing methods are going to become a popular instrument. The benchmarking problem relating today to state aid, in the near future may apply to other circumstances, such as compensation funds, where private firms are asked to finance USO efficient costs. However, in absence of a clear conceptual framework able to fully translate into legal mechanisms economic concepts such as relative efficiency measurements, risks of distorting competition by either excessive or too little compensation may be significant.

The aim of the paper is to show legal and antitrust scholars that appropriate econometric estimates may allow to satisfy the fourth Altmark requirement. In fact by using different functional forms in estimating cost functions it is possible to rank Postal Administration by efficiency only for similar scale of operations (e.g. per capita volumes). The data set is based on the publicly available data set provided by Nera (2004) for its study for European Commission and by Gori et al (2005).

References


