

# 15<sup>th</sup> Conference on Postal and Delivery Economics

May 30 – June 2, 2007  
Semmering, Austria

Presented by

**CENTER FOR RESEARCH IN REGULATED INDUSTRIES**

Rutgers Business School – Newark and New Brunswick

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**Wednesday, May 30, 2007**

5:30 - 7:00	Registration	<i>Registration</i>
7:00	Reception	<i>Reception</i>
8:00	Welcome and Introduction to Conference: <b>Michael A. Crew &amp; Paul R. Kleindorfer</b>	
	Dinner & Speech: <b>Louis F. O'Brien</b> , Senior Vice President – Parcels, Canada Post	<i>Festsaal</i>

**Thursday, May 31, 2007**

7:30	Breakfast		
9:00 - 10:40	<b>Concurrent Sessions</b>		
	<b>COUNTRY STUDIES</b>	<i>Festsaal</i>	<b>REGULATION I</b>
	Chair: Billy Hayes		Chair: Dan G. Blair
	Discussants: Jutta Fabjan, Ken Parmalee & Mark van der Horst		Discussants: Robert Bernau & João Confraria
	<b>James I. Campbell, Jr. and Amelia Porges:</b> The New Legal Framework for Postal Delivery Services in Japan		<b>Jose Anson &amp; Joëlle Toledano:</b> Waiting for 'Rowland Hill' – Elements of Reform of Postal Services in Sub-Saharan Africa
	<b>Maria Carneiro Goldberg:</b> A New Vision of the Brazilian Postal Sector		<b>L. Correia da Silva &amp; E. Payling, P. Dudley, J. Ward &amp; L. Mautino:</b> The Design of the Regulatory Framework for Quality of Service
	<b>Eli Sagi:</b> Challenges in the Restructuring of the Israeli Postal Services Tariffs		<b>Alex Dieke &amp; Sonja Schölermann:</b> Postcodes in Competitive Postal Markets – Is There a Case for Regulation?
10:40 - 11:00	Coffee Break		
11:00 - 12:40	<b>Concurrent Sessions</b>		
	<b>STRATEGY I</b>	<i>Festsaal</i>	<b>REGULATION II</b>
	Chair: Charles E. Fattore		Chair: Jane Dyer
	Discussants: Geoff Bickerton, John Deveen & Derek Osborn		Discussants: Kristin Bergum, Robert Campbell & David M. Levy
	<b>John Baldwin:</b> Quantity and Quality of Postal Sector Employment		<b>Michael Bradley, Jeffrey Colvin &amp; Mary K. Perkins:</b> The Economic Structure of the Postal Accountability and Enhancement Act
	<b>William Dowling, Robert Curry &amp; Bill Worth:</b> Rational Investment Policy in a Post		<b>John Hearn &amp; Joost Callaert:</b> The Accounting and Economic Implications of the EU's New Postal Directive
	<b>S. Gori, L. Deduytsche, J.P. Ducasse, A. Owsiany:</b> The Impact of the Regulatory Environment on the European Mailing Industry – A Scenario Planning Exercise		<b>Robert Cohen, Luigi di Paola, Renee Sheehy, &amp; Vincenzo Visco Comandini:</b> The Distribution of Post Offices in Italy and the United States
12:40 - 2:00	Lunch		<i>Lunch</i>

**Thursday, May 31, 2007 (CONTINUED)**

2:00 - 3:30

**Concurrent Sessions****STRATEGY II***Festsaal*

Chair: Ingo Willems

Discussants: Dennis Delehanty, Gene Del Polito &amp; Sophie Richard

**Luis Jimenez, Michael Lintell, & Anna Owsiany:**

Evaluating Measures of Dispersion to Explain the Unobserved Heterogeneity in Mail Volumes across Countries

**Robert Reisner, Pierce Myers & Lawrence G. Buc:**

Postal Regulatory Reform in the U.S. – Key Issues and Measuring Results

**N. van der Lijn, P. de Bas, A. Meijer:** Development of Competition in EU Postal Markets – Influence of the Regulatory Framework on the Pattern of Competition**DEMAND***Tanzbar*

Chair: Michael J. Shinay

Discussants: Paul Smith, David Stubbs &amp; Gregory Swinand

**C. Cazals, J.-P. Florens, F. Rodriguez, S. Soteri:**

Forecast Uncertainty in Dynamic Models – An Application to the Demand for Mail

**Sacramento Costa & Sonia Pinto:** Micro

Econometric Analysis of Direct Mail Receivers' Choice Purchasing Behavior

**Heikki Nikali:** Substitution of Letter Mail in Different Sender-Receiver Segments

3:30

Break

7:00

Reception

*Reception*

8:00 –

Dinner & Speech: **Stefan Keh**, President of Postal Automation Division, Siemens AG*Festsaal***Friday, June 1, 2007**

7:30

Breakfast

*Breakfast*

9:00 - 10:40

**Concurrent Sessions****COMPETITION POLICY***Festsaal*

Chair: Pekka Leskinen

Discussants: Fabio Filpo, David Parker &amp; Anton van der Lande

**Richard Eccles & Pauline Kuipers:** Potential Effects on Postal Operators of the European Commission's Policy Review on Abuse of Dominant Position**Alessandra Fratini & Joost Vantomme:** Licensing Regimes – Impact of the Recent EC Proposal for a Postal Directive**Denis Šparaš & Nataša Kocjančič:** Entry to the Postal Services Market – Scope and Role of EC Merger Regulation**PRICING & WELFARE***Tanzbar*

Chair: Chris Osborne

Discussants: Joan Calzada &amp; Helmut Dietl

**P. De Donder, H. Cremer, P. Dudley, F. Rodriguez:** Organizational Structures for Postal Operators – Some Results on Pricing and Welfare Economic Issues**Axel Gautier:** Efficient Prices, Delivery Choice and Productivity Gains in a Competitive Postal Market**Urs Trinkner & Christian Jaag:** Optimal Pricing in Competitive Two Sided Postal Markets

10:40 - 11:00

Coffee Break

11:00 - 12:40

**Concurrent Sessions****SERVICE QUALITY***Festsaal*

Chair: Linda A. Kingsley

Discussants: Thomas Baldry, Jody Berenblatt &amp; Norma Nieto

**Peter Koppe & Christian Bosch:** Customer satisfaction as a driver for future Post volumes**Shoji Maruyama:** Empirical Analysis of Demanded Quality of Service in Japan's Postal Market**Karin Pettersson & Per Jonsson:** Survey of the Service Levels and Estimation of Costs Regarding Mail Delivery in Swedish Rural Areas**COST MEASUREMENT***Tanzbar*

Chair: Michael Scanlon

Discussants: João Castro, Richard Robinson &amp; A. Thomas Bozzo

**E. Pearsall, L. Fenster, D. Monaco, & S. Xenakis:** Are There Economies of Scale in Mail Processing? Getting the Answers from a Large-but-Dirty Sample**Leon Pintsov & Andrei Obrea:** Data Requirements for Cost Modeling in a Mail Communication System**Alan Robinson & Richard Waterman:** Trade-Offs in Product Costing – the Statistical Impact of Cost Pool Formation Decisions

**Friday, June 1, 2007 (CONTINUED)**

12:40 - 2:00	Lunch		<i>Lunch</i>
2:00 - 3:30	<b>Concurrent Session</b>		
	<b>USO I</b>	<i>Festsaal</i>	<b>WORKSHARING</b> <i>Tanzbar</i>
	Chair: Bernhard Bukovc		Chair: Pierce Myers
	Discussants: George Houpis, Ilka Meyne, & Richard Moriarty		Discussants: Lawrence Buc, Michael Plunkett & David Treworgy
	<b>F. Boldron, K. Dewulf, D. Joram, C. Panet, B. Roy, &amp; O. Vialaneix:</b> The Accessibility of the Postal Retail Network and the Objectives of Social Cohesion and Economic Development		<b>John Haldi &amp; William J. Olson:</b> Economic Imperatives that Drive Further De-averaging of Postal Rates
	<b>Gonzales d'Alcantara &amp; Axel Gautier:</b> National Postal Strategies after a Full Postal Market Opening		<b>Matthew Robinson, Margaret Cigno, &amp; J.P. Klingenberg:</b> Negotiated Service Agreements in a Regulated Post
	<b>Alberto Pimenta &amp; António Amaral:</b> Peaking into the Future: Modeling the Portuguese Postal Market in Competition		<b>Menahem Spiegel:</b> Socially Optimal Discount for Work-Sharing in the Presence of Mail Heterogeneity
3:30	Break		
7:00	Reception		<i>Reception</i>
8:00 –	Dinner & Speech: <b>Anton Wais</b> , Chief Executive Officer, Österreichische Post AG		<i>Festsaal</i>

**Saturday, June 2, 2007**

7:00	Breakfast		<i>Breakfast</i>
9:00 - 10:35	<b>USO II</b>		<i>Festsaal</i>
	Chair: Nancy Sparks		
	Discussants: Ruth Y. Goldway, Alberto Rovero & Vincenzo Visco-Comandini		
	<b>Helmuth Cremer, Philippe De Donder, François Boldron, Denis Joram, &amp; Bernard Roy:</b> Social Costs and Benefits of Universal Service Obligations in the Postal Market		
	<b>Michael A. Crew &amp; Paul Kleindorfer:</b> Regulation and the USO under Entry		
	<b>Derek Holt, Leonardo Mautino &amp; Felipe Florez-Duncan:</b> Funding Universal Service Obligations in the Postal Sector		
10:35 - 11:05	Coffee Break		
11:05 - 12:55	<b>RESEARCH PANEL</b>		<i>Festsaal</i>
	Chair: <b>David Williams</b>		
	Panelists:		
	<b>James I. Campbell, Jr.</b>		
	<b>Stephen C. Littlechild</b>		
	<b>Walter Maschke</b>		
	<b>James C. Miller III</b>		
	<b>John Panzar</b>		
	<b>Joëlle Toledano</b>		
	<b>Anton van der Lande</b>		
	<b>Joost Vantomme</b>		
12:55 - 1:00	Concluding Remarks – Michael A. Crew		
1:00	Lunch (Conference Ends)		<i>Lunch</i>

## POSTAL AND DELIVERY ECONOMICS PUBLICATIONS

The following edited books resulted from Previous Postal Conferences:

- *Competition and Innovation in Postal Services*, edited by M.A. Crew and P.R. Kleindorfer, Kluwer Academic Publishers, 1991
- *Regulation and the Nature of Postal and Delivery Services*, edited by M.A. Crew and P.R. Kleindorfer, Kluwer Academic Publishers, 1992
- *Commercialization of Postal and Delivery Services: National and International Perspectives*, edited by M.A. Crew and P.R. Kleindorfer, Kluwer Academic Publishers, 1994
- *Managing Change in the Postal and Delivery Services*, edited by M.A. Crew and P.R. Kleindorfer, Kluwer Academic Publishers, 1997
- *Emerging Competition in the Postal and Delivery Services*, edited by M.A. Crew and P.R. Kleindorfer, Kluwer Academic Publishers, 1999
- *Current Directions in Postal Reform*, edited by M.A. Crew and P.R. Kleindorfer, Kluwer Academic Publishers, 2000
- *Future Directions in Postal Reform*, edited by M.A. Crew and P.R. Kleindorfer, Kluwer Academic Publishers, 2001
- *Postal and Delivery Services: Pricing, Productivity, Regulation and Strategy*, edited by M.A. Crew and P.R. Kleindorfer, Kluwer Academic Publishers, 2001
- *Postal and Delivery Services: Delivering on Competition*, edited by M.A. Crew and P.R. Kleindorfer, Kluwer Academic Publishers, 2003
- *Competitive Transformation of the Postal and Delivery Sector*; edited by M.A. Crew and P.R. Kleindorfer, Kluwer Academic Publishers, 2004
- *Regulatory and Economics Challenges in the Postal and Delivery Sector*, edited by M.A. Crew and P.R. Kleindorfer, Kluwer Academic Publishers, 2005
- *Progress toward Liberalization of the Postal and Delivery Sector*, edited by M.A. Crew and P.R. Kleindorfer, Springer, 2006
- *Liberalization of the Postal and Delivery Sector*, edited by M.A. Crew and P.R. Kleindorfer, Edward Elgar, 2006

The following is a text on postal economics:

- *The Economics of Postal Service*, by M.A. Crew and P.R. Kleindorfer, Kluwer Academic Publishers, 1992

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

## CONFERENCE STAFF

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The **Center for Research in Regulated Industries (CRRI)**, located at Rutgers University, aims to further study of regulation by research in economics, finance, and institutions. Its publications, seminars, workshops, and courses make available the latest advances to academics, managers, consultants, and regulatory commission staff. The Center has over twenty-five years of experience providing research, instruction, conferences, courses, seminars, and workshops in economics of network industries. The Center's *Journal of Regulatory Economics* is an international scholarly bi-monthly publication intended to provide a forum for the highest quality research in regulatory economics. CRRI was the recipient of The Hermes Award, 1992, awarded by the European Express Association.

## SPEAKERS, DISCUSSANTS &amp; CHAIRS

- Jose Anson**, Economist, Universal Postal Union  
**John Baldwin**, Head of International Affairs, CWU  
**Jody Berenblatt**, Senior Vice President – Postal Strategy, Bank of America  
**Kristin Bergum**, Director – Regulatory Affairs, Posten Norge AS  
**Robert Bernau**, Competition and Regulatory Manager, New Zealand Post  
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**Nancy S. Sparks**, Managing Director - Regulatory Affairs, FedEx

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**David Stubbs**, Europe Economics  
**Gregory Swinand**, Senior Consultant - Regulatory Division, London Economics  
**Joëlle Toledano**, Commissioner, ARCEP  
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**Frank Rodriguez**, Head of Economics, Royal Mail  
**Bernard Roy**, Head - Department of Regulatory Economics, La Poste  
**James Sauber**, Research Director, National Association of Letter Carriers  
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## HOTEL INFORMATION

The conference will be held in Semmering Austria. The conference site is:

Hotel Panhans Phone: + 43/26 64/81 81; Fax: + 43/26 64/81 81-513  
Hochstrasse 32b,  
2680 Semmering, Austria [hotel@panhans.at](mailto:hotel@panhans.at) [www.panhans.at](http://www.panhans.at)

Hotel reservation forms can be obtained at our web site (<http://crri.rutgers.edu/post/>). The reservation forms must be sent to the Hotel Panhans. The Conference rates for the Hotel Panhans are 117 €a night for a daily room single use with meals and 184 € for double room with meals. There will also be rooms available in the CD Palace Hotel, rates for the CD Palace are 96 €a night for a daily room single use with meals and 166 €for double room with meals. The rates for two days before and two days after the conference at the Hotel Panhans are 77 €per night for single and 104 €for a double; at the CD Palace are 56 €per night for single and 86 €for a double. Please note on reservation form that you are attending the 15th CPDE (Rutgers University). The deadline for reservations is May 1st. However, hotel space is limited it may fill earlier than May 1st.

## FEES AND EXPENSES

- A registration fee of \$1,300 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 Panhans or the CD Palace 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
  - Online access to the conference proceedings
  - A CD-ROM with complete proceedings (papers and presentations) after the conference.
  - A copy of the edited volume resulting from the conference (approximately 6 months after the conference).

Please forward the Registration Form to Jeremy T. Guenter at:

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*December 15, 2006*

Abstract for the 15th Conference on Postal and Delivery Economics

“The New Legal Framework for Postal Delivery Services in Japan”

J.I. Campbell Jr. (Brown Rudnick LLP)  
and A. Porges (Sidley Austin LLP)

**Background.** In October 2005, Japan adopted a package of six laws providing for privatization of Japan Post Public Corporation. However, the basic motivation for these laws was to unlock the billions of dollars in banking and insurance assets held by Japan Post, not to modernize Japan’s legal framework for postal delivery services. The package represents a major milestone for Japan, but also a major missed opportunity.

Under the privatization laws, the current Japan Post Public Corporation will be succeeded by several new “successor companies” led by a new corporation, Japan Postal Services Corporation (JPSC). In January 2006, JPSC was incorporated as a shell corporation owned by government. JPSC will own all of the stock of four subsidiary operating companies that will provide postal delivery, counter services, banking, and insurance. In October 2007, Japan Post will be dissolved and the successor companies will come into full existence. In the decade following, government is obliged to sell up to two-thirds of its JPSC stock “within the shortest possible time,” and JPSC itself is obliged to sell all stock in the banking and insurance subsidiaries. The privatization laws also change the legal framework affecting the postal and express delivery market in Japan, deregulating parcel delivery and partly freeing the new postal delivery company to enter express delivery. It does not, however, open the possibility of meaningful competition in delivery of mail.

**Objectives of the paper.** This paper is designed to provide a critique of the new framework for private delivery services in Japan as the Japanese government implements the privatization package of 2005. The paper will consider both anomalies in the legal framework and the degree to which Japan has adopted (or not) lessons from postal reform in other countries.

**Approach of the paper.** The paper will be based primarily upon analysis of the privatization and postal laws of Japan, the implementing measures adopted in 2006 and early 2007, a report by the Japan Fair Trade Commission, statistics from Japan Post, and other policy reports and documents from the implementation process.

**Ways in which the contributions of this paper are original.** There has been relatively little detailed analysis by postal scholars of the effects of privatization on the postal delivery system of Japan (see next section). Academic Japan specialists generally lack a grounding in the postal regulatory issues; on the other hand, postal experts from outside Japan have not had access to the full legal and policy background, including the privatization package, postal laws and other policy reports. The proposed paper will be the first analysis that draws on translations

of these original sources, compares the Japanese privatization with postal reform efforts elsewhere, and provides an objective assessment of the Japanese package as postal reform.

**Relationship to previous Conference papers.** This paper is in some respects a followup to the Leong and Porges paper (2006). That paper provided a substantial account of the background of the 2005 privatization laws and raised several questions about how they would be implemented. That paper did not consider the relationship between privatization and the postal laws and could not address the implementation activities of 2006. The paper is less directly related to a paper by S. Maruyama (2006), another pre-privatization paper that argued that experience in postal liberalization outside Japan could not be readily applied because of the nature of Japan's postal market. The paper will also draw up other CRRRI papers as appropriate, e.g., Mizutani and Uranishi (2003).

**Why the paper is likely to be interesting.** This paper will provide a critical assessment of the implications of the privatization package for reform of postal delivery in Japan. The paper will discuss missed opportunities for improved performance of the postal delivery sector, and how these flaws link to the essentially non-postal approach taken to postal modernization. The paper will also suggest possible remedies. The paper should be of interest to governmental and postal officials in Japan, and in other countries considering postal modernization. It may also be of interest to competitors of Japan Post and to potential investors in JPSC.

**Timeliness of this paper.** This paper will appear just before Japan launches the corporate successors of Japan Post and begins the 10-year transition in which shares in the successor companies will be sold to the public. What happens in Japan could, in turn, affect unresolved debates on postal reform in the other two leading Asian economies, China and India.

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Abstract for the 15<sup>th</sup> Conference on Postal and Delivery Economics

“A new vision of the Brazilian Postal Sector”

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The State of the 21st century is not the same as the State of the 60s, 70s and 80s of the 20th century. The terms “de-statization”, “liberalization”, “deregulation” and “privatization” began to take part in the public law vocabulary in the 90s of the 20<sup>th</sup> century. The acting of the State in the economic domain has been smoothed and the private initiative has been stimulated. The search for efficiency both in the management of public resources and in the rendering of public services are now the principal goals of the State.

Additionally, Brazilian press has constantly published articles covering the following themes, among others: transformation of Deutsche Post from an underperforming domestic enterprise into the largest European postal group, with annual revenues of €43 billion; the privatisation of Japan’s post office and the privatisation of the communications sector can allow cuts in staffing levels while at the same time providing increased revenues for the companies and better public access to services. Such a level of press coverage shows how prominent this issue is in Brazil, where the international examples have increased the appeal of liberalising the postal service.

To this end, the present paper performs, firstly, a panorama of the above-mentioned changes and intends to demonstrate their influence in the Brazilian postal sector.

In addition, the postal “monopoly” theme is faced, including the verification of its existence *de facto* and *de jure* and the legal possibility of amendment of its form of exploration in accordance with the current Brazilian constitutional context. The diversity of segments should imply a shift in the way Brazilian courts analyse the postal sector, particularly when considering liberalisation. However, this shift has not been happening in Brazil. Many decisions by the Brazilian courts appear simply to ignore the changes that have occurred in the sector. They only use a simple analysis of the infra-constitutional law on the matter, without an adequate interpretation of the Federal Constitution in light of the sector’s current reality.

Finally, the paper intends to examine the legal institutions that enable the increase of private investments in the postal sector, highlighting the possibility of transforming the Empresa Brasileira de Correios e Telégrafos – ECT (Brazilian public postal incumbent) in a corporation with public and private shareholders, the concessions, permissions, authorizations and public-private partnerships for the rendering of postal services and the creation of a regulatory agency for the postal services, all in the most strict conformity with the new profile of the State.

# ***Challenges in the Restructuring of the Israeli Postal Services Tariffs<sup>1</sup>***

***Eli Sagi***

The Israeli delivery sector has been undergoing a process of liberalization during which it gradually moves from being fully dominated by a governmental authority into a competitive, partly regulated, market. As of 2006, the governmental Postal Authority has become a governmental company (Israeli Postal Company or IPC) and the market is gradually opening to competition and a new price system is about to be implemented.

A public experts committee (the Tariffs Committee), chaired by the author of this paper, was nominated to suggest a new set of tariffs for the regulated services provided by IPC that will promote efficiency in this market, allow the development of competition while securing the provision of universal service and the financial stability of its provider (IPC). The committee's recommendations were rejected by both sides. On the one hand, IPC argue that the implementation of the proposed tariffs is bound to result in heavy losses for the company and put the future of the universal service at great risk. On the other hand, potential competitors complain that the proposed system leaves no chance for effective competition.

The purpose of this paper is to present and discuss the fundamental challenges faced by the Committee. It will argue that the it's recommendations do have a fair chance of achieving the complex goal of increasing the efficiency in the market, opening the door for effective competition without endangering either the financial stability of IPC nor the provision of the universal service.

The paper will hold three chapters:

1. **The Israeli delivery sector.** This chapter will describe the current status of the market and the process of liberalization it has been undergoing. The special characteristics of the market will be emphasized (such as the role of "delivery centers", the business joint project between printing and delivery companies etc.).
2. **The price regime.** This chapter will present the existing tariff system, point to its key shortcomings. It will describe the basic methodology and the general approach applied by the Tariffs Committee, and we briefly discuss a few of the main challenges it was facing.
3. **Key dilemmas.** This chapter will elaborate on two most fundamental and controversial decisions taken by the committee and their implications:
  - a. Adopting absorption costing (rather than contribution costing) methods to all IPC services, including those open to competition. i.e., allocating administrative and general expenses to bulk mail as well as to household mail. In the same line – the costs associated with the postman's walking along his route were applied to bulk mail as well.

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<sup>1</sup> **Dr. Eli Sagi, Berglas School of Economics, Tel-Aviv University, Israel**

Paper prepared for the XVth International CRRI Conference for June 2007, Semmering, Austria.

- b. Opening the delivery centers to all providers. In certain areas in Israel, mail is delivered to specially designated centers from where addressees are supposed to collect them (rather than being delivered directly to their address). These centers consist of a much cheaper mean of delivery. A significant portion of the mail is delivered to them. They are owned by IPC and competitors are currently prohibited from entering and delivering mail in them. Allowing competitors in requires differential pricing for mail addressed to such centers as well as setting an access fee for competitors and an administrative apparatus to the ensure proper collection of these fees.

This paper aims to contribute to the understanding of the process of postal liberalization, including the key role that regulation and pricing play in balancing the interests of various stakeholders in the liberalization process. Reference material from previous CRRRI conference volumes on liberalization and regulation will provide comparative benchmarks to related issues in other partially liberalized markets.

## The Economic Structure of the Postal Accountability and Enhancement Act

Michael D. Bradley  
George Washington University  
Washington, DC

Jeff Colvin  
United States Postal Service  
Washington, DC

Mary K. Perkins  
Howard University  
Washington, DC

With the evolution of postal regulatory regimes around the world, research on alternative regulatory structures has become increasingly important. In this paper, we contribute to this research by analyzing the economic structure embodied in the new postal regulatory framework in the United States. Recently, the United States Congress passed sweeping legislation that significantly changes the regulatory regime governing the United States Postal Service. Known as the Postal Accountability and Enhancement Act (PAEA), the new legislation provides additional powers for the postal regulator and some additional market flexibility for the Postal Service. For example, one major change is in the way prices for postal products are set. "Market dominant" products will be subject to a price cap that can be adjusted only for increases in the cost of living. Although the economics of price caps in the postal sector has received a fair amount of attention, the work has generally focused on optimal pricing and has analyzed global price caps. For example, Billette De Villemeur, Cremer, Roy and Toledano (2003) examine a global price cap for a postal operator that provides work sharing discounts and identify the optimality properties of a global price cap. Also,

deDonder, Cremer, Dudley, and Rodriguez (2006) look at the interaction of a global price cap and universal service requirements.

However, the PAEA does not specify a global price cap. Price cap regulation covers only a subset of the Postal Service's products, may be product specific, and possibly could involve different "x-factors" for different products. Moreover, only the letter mail products are under the price cap and the PAEA allows parcel and expedited products to be priced to market. Finally, even those products covered by the price cap must continue to cover their attributable costs.

In this paper, we examine the economic implications of this new regulatory structure, considering possible impacts on the Postal Service, its customers and its competitors. We construct a model reflecting both the partial price cap regime and the variety of cost tests that products must pass. We model the nature of these regulatory rules for a postal operator no longer subject to a breakeven constraint and analyze its possible effects under a variety of scenarios about the future conditions of the postal market.

## Abstract

### “Regulation and the USO under Entry”

M. A. Crew and P. R. Kleindorfer  
Rutgers University and University of Pennsylvania/INSEAD

The postal sector is now in the midst of major change, especially in Europe as the EU moves to open up postal markets to competition. However, it will certainly not be the end of regulation, which can be expected to remain an essential element of governance for postal markets for the foreseeable future. Notwithstanding the importance of regulation under FMO, appropriate models for postal regulation have been slow to emerge, and there still remains considerable variety across countries in this respect (e.g., WIK, 2006). The paper will examine how the USO might be funded under FMO without explicit subsidies, focusing on the role of regulation and antitrust. The paper will assume that the incumbent PO is subject to price cap regulation (PCR).

While attitudes about competition in the postal sector vary widely across countries, the major concern is that the USO could not be readily funded without the traditional reserved area (PwC, 2006). Indeed, if the reserved area were abolished, the competition faced by POs might be greater than that faced by traditional network industries, in part because there are lower entry barriers. So if the EU abolishes the reserved area in Europe in 2009, postal markets may arguably be subject to more competition than other network industries and may lack the wherewithal to fund the USO. This already is giving rise to an increasing role for regulation in the postal sector, including concern over preserving the USO after FMO, and increased commercialization and privatization leading to claims by competitors of the need for a level playing field under FMO.

Under FMO, regulation has to address a number of conflicting objectives. The USO has to be funded and yet if market dominance becomes excessive, competition cannot survive. Alternatively, fostering competition may lead to excessive and inefficient entry and may dissipate the funding for the USO. Attempts by regulators to preserve an overly burdensome USO or an overly detailed implementation of PCR will also have deleterious effects. Finally, the paper will address policy implications and future developments. The role of analysis is limited because of the ultimate role of judgment. The paper will summarize some basic principles that could apply to the design and implementation of PCR in the postal sector. Perhaps a clearer statement of these could help avoid some of the problems that PCR has experienced in the past in other industries.

The paper will be primarily policy oriented but will employ some basic models of regulation. The topic of postal regulation and FMO has only briefly been covered in the authors' earlier work, though there have been several surveys of current practice.

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## **The accounting and economic implications of the EU's new Postal Directive**

John Hearn and Joost Callaert

This paper is a forward looking paper.

The European Commission has published its proposals for a new Postal Directive confirming the date of 1 January 2009 for the full accomplishment of the internal market for postal services within the European Union and adapting the current regulatory framework to a situation which appropriate to the provision of postal services following Full Market Opening (FMO).

The paper will examine the accounting and economic issues that will need to be addressed by the independent National Regulatory Authorities (NRAs) following FMO. The objective is not to draw conclusions about which method or option is best but to set out the issues that will need to be considered and to illustrate the impact that the decisions taken can have on the market. The paper will draw extensively on the authors' extensive experience of postal regulation, their input to CERP's document "Best Practices for cost accounting rules" and CERP's "Report Cost Accounting and Price Control", and postal operations generally.

The first section of the paper will set out assumptions about the key policy decisions which NRAs will have to enforce, especially the scope and financing of Universal Service, the extent of Price Control, and the interoperability of postal networks.

The second section will examine the options for NRAs with regard to price control. Options with regard to the different types of price control and the scope of price control will be identified and the advantages and disadvantages of each will, so far as possible, be quantified.

The third section will examine the options for NRAs will regard to the interoperability of postal networks. Cross-border mail has historically been dealt with by granting operators in

other countries access to the monopoly network in the country of destination. Until the latter half of the last century this was done on a “knock for knock” basis, but even today prices are rarely set on a fully cost reflective basis. The options for NRAs with regard control of access prices will be identified and the advantages and disadvantages of each will, so far as possible, be quantified.

The fourth section will examine the options for NRAs with regard to financing the provision of Universal Service. Methods for establishing whether the provision of Universal Service, or any particular aspect of it, represents an undue burden on the designated provider(s) will be identified and the advantages and disadvantages of each will, so far as possible, be quantified.

The final section will consider the accounting information that NRAs will require to enable them to undertake their responsibilities. Issues including methodology, scope, accounting principles, frequency of preparation and audit will be considered. The advantages and disadvantages of the various options will, so far as possible, be quantified and the need for publication, at least at a summary level will be explored. The need for the accounting information to be supplemented by economic analysis will also be addressed.

References: CERP: *Best Practices for cost accounting rules and*

CERP: *Report Cost Accounting and Price Control*

# **Quantity and Quality of Postal Sector Employment---A Study of the Effects of Corporatisation/Liberalisation/Automation on the Quality of Employment in the Universal Service Providers ( USPs ) of the United Kingdom/France/Sweden**

By

John Baldwin  
Head of International Affairs  
Communication Workers Union

## 1 Objectives

To analyse and assess the effect of the corporatisation of the USPs commencing in the 1960s/the automation and centralisation of mail processing commencing in the 1970s/the liberalisation of the letter markets commencing in the 1990s on the level and quality of employment in Royal Mail/La Poste/Sweden Post

## 2 Methodology

The prime source material will be the published annual reports of Royal Mail/La Poste/Sweden Post from 1968 to date. In addition reference will be made to the various reports commissioned by national Governments the European Commission and the Trade Unions in the period under review. Use will also be made of the archives of Royal Mail/La Poste/Sweden Post and the Trade Unions.

## 3 Originality

This will be the first paper to be presented to a Rutgers conference that attempts to assess the impact of corporatisation/liberalisation/automation on the quality and quantity of jobs in the postal sector. The effect on efficiency has been examined many times but the radically changed and changing nature of employment in the sector has not previously been given sufficient attention.

## 4 Interest

The Trade Unions consider that there is a direct link between the quality of employment and the quality of service that a USP can offer all customers whether bulk mailers or individual citizens. The Trade Unions consider this link to be of vital import to the financial viability of all the actors in the postal market.

## 5 Timing

The European Commission unveiled proposals for full market opening at 1 January 2009 via a draft directive published in October 2006. Current indications are that the German Presidency of the European Union held until July 2007 will be aiming to broker a deal on an agreed directive in June 2007

Abstract: Rational Investment Policy in a Post

William J. Dowling, Robert Curry, Bill Worth

This paper raises the issue of a change in strategic direction for posts. Although most posts offer a variety of products, generally they can be categorized into two market groups that have very different characteristics. Those differing characteristics and the regulated environment in which posts operate help explain why posts tend to make different investment choices from private couriers.

Utilizing data provided by posts this paper will examine the linkages between product groupings, strategy, the regulated environment and capital investment policy. The authors will contrast the regulated posts with the private sector couriers and attempt to explain the significant differences in investment policy.

The two market groups are traditional postal communication products and the package/express market. This paper will examine characteristics of those markets and attempt to draw conclusions about appropriate investment policy. The approach will lean heavily on the authors experience with the United States Postal Service, as well as, analysis of market and economic data presented to the Postal Rate Commission. However, the authors believe that the analysis and conclusions would be of interest to other posts as they consider the circumstance of their products and markets.

The relative size of these markets and the opportunity to expand market share will be examined to illustrate the importance of focusing strategy and investment policy in those

areas where posts have the best opportunity to succeed. The authors believe that participation in both traditional communication products and package/express is appropriate for the success of the post. In addition to making significant contribution to overhead, such participation serves particular segments such as household and micro entrepreneurs particularly well. However, the analysis will show that limited capital funds need to be focused primarily on the large traditional communications market.

In addition to the market forces impacting on investment policy, the authors believe that as a consequence of being a regulated entity in the public sector, investment strategies are open to comment and influence by a broad range of stakeholders that have very different motivations than the stockholders of private sector couriers. The rate setting process for the USPS opens not only investment strategy to public comment but a substantial body of data for examination and comment by such diverse stakeholders as advertising mailers, unions and even competitors. Obviously these groups have divergent interest in not only pricing of USPS products but management policies that drive those prices.

The paper links to the authors previous work “The Postal Technology Market and Effects on Purchasing Strategy” which discussed the market power of the posts as automation buyers, its’ influence on supplier relationship and the ability of the post to achieve productivity improvements. The paper is of some importance because appropriate investment resource allocation is a necessary factor in success of the post, particularly in achieving productivity goals, and a broad range of stakeholders have interest in considering this topic.

# "The impact of the regulatory environment on the European Mailing Industry: A scenario planning exercise"

by *Stefano Gori*, PHD student UWE, Bristol [stefgori@yahoo.com](mailto:stefgori@yahoo.com)

At a time of rapid change in the European Mailing Industry regulatory environment, this paper employs scenario planning techniques to analyze the impact in the next decade of the evolving regulatory environment on 3 dimensions of the industry: 1) the size, 2) the level of vertical integration and 3) the level of “commodization” of mail.

The objectives of the paper are: 1) to provide a “map” of potential feasible futures for the European Mailing Industry, 2) to identify a) the relevant uncertainties and b) the associated signposts. This is likely of interest to the different industry players so that they can determine contingent actions, overhaul or fine tune their strategies and define medium- and long-term investment plans.

It focuses on 4 “regulatory factors” (derived from the factors identified by Kleindorfer (2006)) and describes their impact on the three dimensions of the industry. The four factors are the regulatory environment related to: I) end-to-end competition, II) access, III) pricing of Universal Service Provider’s (USP) products and IV) the scope and funding of the Universal Service Obligation (USO).

I-Competition end-to-end, The European Commission confirmed the 2009 date for the full liberalization of the market but the national postal law and the attitude of national political and regulatory bodies will have a bigger impact on the national market end games (size, integration, innovation). In the process of mapping the possible futures the author believes that the decisions of National governments, legislators and regulators are mainly shaped by: i) the level of independence and the amount of resources dedicated to the National regulatory postal authorities and ii) in the political arena, the predominance of socio-economic cohesion arguments versus pro competition positions or vice versa.

II-Access: as Gerardin (2006) presented last year at the Rutgers’ Conference, there are three options on access: i) a mandated regime defined at the European level (it is not the case of the recent Commission proposal), ii) a mandated regime defined at the national level and iii) no mandated access regime. To understand the impact of case i), ii) on the three dimensions (size, level of worksharing and commoditization), the paper addresses two important issues that shape end games (*Bilette de Villeneuve E., et al., 2003 and De Donder P. et al. 2003*): a) type of access, and b) who regulates it? Regarding (a), one of the possible scenarios analyzed is the application of UK Telecom “Openreach” model (2005) to the postal sector (separation of last mile actives from the rest of the network company, subsequently mandated and regulated access only in the last mile and commercial non mandated access upstream).

III-Pricing: The possibility of “commercial freedom” for USP in setting prices will certainly have an impact on the USP, especially in those countries that currently have in place a price cap (*Avolio and Scarfiglieri, 2006*) and on the revenues and strategies of the other stakeholders (customers, competitors, suppliers). This paper addresses to what extent this “freedom” would impact the three dimensions noted above.

IV-The USO has been historically identified with uniform price and ubiquity of service, but these attributes are now being questioned. The recent proposal of the Commission leaves room for national governments to define the USO. This paper employs scenarios to analyzes how the different choices available to the national authorities on: i) minimum days of delivery (national and remote areas), ii) level of

quality required, iii) financing of the obligation (general taxation, compensation fund financed by all operators), iv) extending of some obligations on non incumbent operators, lead to different scenarios concerning the size, integration and commoditization of the national markets.

To carry out this scenario planning exercise, the author has utilized literature on scenario planning (*Schoemaker, 2002, Shell, 2005*) along with the European Commission's proposed directive (*2006*), the experience of other regulated industries (*Crew and Kleindorfer, 2002, Armstrong and Sappington 2006*), previous scenario exercises in the mailing industry (*TPG, CGEY, 2003, Strikwerda et.al, 2005, Jimenez, 2005*) and the feedback from 20 thought leaders, as summarized in a paper presented by the author at last year's Rutgers Conference (*Crews, Gori et.al 2006*).

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## **Waiting for “Rowland Hill”: Elements of Reform of Postal Services in Sub-Saharan Africa**

The paper tackles the possible reasons for the lack of development of postal communication in Sub-Saharan Africa (SSA), and goes beyond the macroeconomic and demographic drivers already exposed in Ansón, Cuadra, Linhares, Ronderos and Toledano (2007). We highlight that in SSA both the sender of a letter item and the addressee, through the rental of a P.O. box, pay for a letter exchange. Using a club effect approach, we explain how the current pricing hinders postal development in SSA. Fee-paying delivery to P.O. boxes reduces interest in using the Post because the total number of addressees who can be reached is substantially reduced by the obligation to rent a P.O. box. While this question does not arise for the industrialized countries where the universal service guarantees free delivery to all potential addressees, this issue is one of the keys to the slow growth of a certain number of postal markets in the developing countries which have opted for fee-paying P.O. box delivery. Not only the pricing chosen limits postal communication, but it also contributes to an uneven distribution of P.O. boxes and delivery points throughout the territory: P.O. boxes are where a sufficient number of people can afford them. Yet concentrating the postal delivery infrastructure in two or three towns reduces the advantages of using the public postal operator still further. Beyond the pre-Rowland Hill pricing issue, one must also consider the users' endemic lack of trust in the postal operator, which fosters extensive self-delivery as well as the use of expensive private couriers and unlicensed competitors.

The approach adopted for this paper is mainly empirical. A unique survey of postal delivery in 26 Sub-Saharan African countries has been organized providing invaluable information about their current situation. Various dimensions of the postal sector in Sub-Saharan Africa, such as access to delivery, pricing, the geographical organization of the networks, competition, trust in the public postal operator have been measured through an extensive number of indicators at several geographic layers. This in turn enables several econometric analyses answering theoretical issues; among other results, they point out the negative effect of an uneven geographical distribution of the postal delivery infrastructure on the level of mail communication, or the strong positive correlation between the prices paid by the sender and the receiver.

Finally, the results of this research provide insights to a sound reform of the postal sector in least developed African countries.

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**ABSTRACT FOR THE 15<sup>TH</sup> CONFERENCE OF POSTAL AND DELIVERY  
ECONOMICS  
May - June 2007**

**The Design of the Regulatory Framework for Quality of  
Service**

Luis Correia da Silva (Oxera), Elizabeth Payling (Royal Mail), Paul Dudley (Royal Mail), John Ward (Oxera) and Leonardo Mautino (Oxera)

Regulation is frequently viewed as a surrogate for competition such that it can be withdrawn as competition develops. This also applies to the regulation of quality of service.

For the universal service provider's (USP) services where there is market dominance, the regulatory framework for the USP needs to encourage the maintenance and improvement of service quality provision to its customers during periods of price or revenue restraint and organisational change designed to improve efficiency. These incentives may involve alternatives such as penalties and/or rewards for under- or over-performance. Quality of service targets—performance against which needs to be measurable and auditable—are seen as a means of identifying when standards have improved or fallen. Penalties and rewards in relation to the achievements of the operator relative to these targets typically involve choices about the level of compensation to customers, adjustments to allowed revenues and the use of fines.

For USP's services where there is competition, quality of service measures provide signals for markets that can influence choice. This has implications for the information that the regulatory framework needs to ensure is available to customers from all operators. It also raises the issue of the need for any other regulation specifically for quality of service in such an environment.

This paper looks at how to design the regulatory framework of quality of service for the USP. It considers what different measures are available to assess quality of service in the postal sector. It considers how quality of service performance is incentivised in different markets, and how this relates to both regulated and unregulated postal services. It considers approaches to assess how to take account of the target level of quality of service in setting the level of regulated revenue for the USP, including an adjustment made to the USP's cash-flow forecasts and USP's allowed rate of return. It also considers how the control can be designed to incentivise the maintenance and improvement of performance in quality of service.

Abstract for the 15th Conference on Postal and Delivery Economics

**“Postcodes in competitive postal markets: Is there a case for regulation?”**

Alex Dieke and Sonja Schölermann

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In most countries, postcodes have been developed by postal operators/administrations long before the core postal markets were exposed to competition. Postcodes were largely regarded as internal operational systems and their designs reflect the operational necessities of the postal operator/administration. However, postcode systems exhibit significant spill-overs (external effects). For example, changing postcodes cause transaction costs for anybody that uses them, including senders and receiver. In addition, they affect many users outside the postal sector that, e. g., use postcodes to specify unique addresses when using automobile navigation systems. In competitive letter markets, alternative operators emerge as additional users of postcode systems, as had parcel and express carriers before.

In October 2006, the European Commission has presented a proposal for a new Postal Directive. Amongst others, this proposal stipulates that

Whenever necessary to protect the interest of users and/or to promote effective competition, and in the light of national conditions, Member States shall ensure that transparent and non-discriminatory access conditions are available to the following elements of postal infrastructure or services: **postcode system**, address database, post office boxes, collection and delivery boxes, information on change of address, redirection service, return to sender service.<sup>1</sup>

Against this background, the paper will discuss whether or not there is a need for regulating design and operation of public postcode systems. For that purpose, the paper will investigate two potential causes for regulation: (i) The extent to which postcodes are to be considered as public goods; and (ii) the opportunity for anti-competitive conduct related to the incumbent's control over the postcode system.

First, the paper will analyze postcode systems from the perspective of public goods theory. This analysis will consider the value of postcode systems – or parts of the postcode system – to both senders and recipients. Second, the paper will assess opportunities for anti-competitive conduct by incumbent operators that control national postcode systems; based on the case study of Germany. Third, the paper will review regulatory control over postcode systems (e. g. in Sweden and the U.K.) and discuss whether there is a need for regulators to get involved in the operation of postcode systems.

While all European regulators and/or policy makers will have to respond to the Commission's proposal, there is little research on this topic. The paper will aim at clarifying the role of postcode systems in competitive markets and identifying the scope of regulatory intervention that may be needed from an economic perspective.

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<sup>1</sup> Commission of the European Communities, Proposal for a Directive of the European Parliament and of the Council amending Directive 97/67/EC concerning the full accomplishment of the internal market of Community postal services, COM(2006) 594 final.

**Evaluating measures of dispersion to explain the  
unobserved heterogeneity in mail volumes across countries**

Luis Jimenez, Michael Lintell, Anna Owsiany<sup>1</sup>  
Pitney Bowes, Inc. – 2007

Mail volumes have long been observed to be strongly correlated to measures of economic activity, such as GDP, as shown in a wide body of work cited in our references. Diakova's paper examined broadly the literature of models and data on this subject and agreed with Nader's empirical observation of a weakening relationship recently between economic activity and mail volumes. Harding provided the first-ever comprehensive review of the literature on mail demand models, and subsequently undertook a groundbreaking study using panel data for seven countries. His model disaggregated mail flows into six sender-recipient streams and considered the most extensive ever number of relevant drivers for each stream, using principal components analysis to explain the variation between the model predictions and the actual observations. However, Harding also concluded that the unobserved heterogeneity of demand across countries remained largely unexplained, even after trying dozens of external drivers. In short, countries with otherwise similar average economic and social structures – i.e., income, population, number of businesses, geographical area – have widely differing mail volume intensity per capita. These differences across countries have, therefore, not yet been explained in prior models by the use of variables that measure only the average intensity of each effect .

This study draws from an insight in other industries (e.g., health care) showing that the level of income inequality *within* a country can be used to describe heterogeneity *across* countries. Thus, the conjecture arises that the unobserved heterogeneity of mail volume per capita across countries with otherwise similar average characteristics may be, in part, explained by the divergence of social and economic structures over time. These differences across countries can, therefore, only be represented by measures of dispersion across the country's regions or economic and social strata. In this research, we build upon the data set constructed by Harding and then further evaluate whether "divergence" variables such as a population's income dispersion (as measured by the Gini coefficient) or the degree to which a country is "networked" (as defined by Metcalfe's Law) are a determinant of the unobserved heterogeneity, while controlling for the level of economic activity (e.g., GDP). For example, we assess whether countries with greater income inequality or with greater dispersion of the density of businesses or households by geographical subdivision are inherently – and consistently – more or less "efficient" in generating mail demand, all other conditions being equal.

Our analysis begins by postulating a variety of measures of dispersion, and applies them to the Harding data set of country statistics for separate mail flow segments and tests whether the "within country" dispersion is helpful in explaining the unobserved heterogeneity of mail demand. Significant variables identified with this approach would be expected to increase the explanation of mail demand in more sophisticated econometric models, such as the one proposed by Harding, and would thus readily lead to new research into improved econometric mail demand forecasting models. This paper thus contributes to the growing body of literature that seeks to understand the determinants of mail demand.

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## **Measuring Results: What Will Postal Reform Achieve and How Will We Know It?**

### **Issues Facing The Future Transformation of the US Regulatory System**

Robert Reisner, James Pierce Meyers and Lawrence Buc

For a number of years, the creation of the U.S. Postal Service in 1970 was seen as a “reform model”. Certainly in comparison with the Post, Telegraph and Telecom (PTT) state owned monopoly model, economists, regulators, policy makers, postal executives and customers saw the concept of a businesslike independent government entity as a superior vehicle for creating consumer and social value.

In the 1990s, this comparison changed as many posts (including virtually all European posts) adopted postal reforms. Some postal executives in the US did note that the American system of worksharing with the private sector represented far more of a reform model than generally acknowledged<sup>1</sup>. But the commencement of a debate over postal reform in 1995 has been watched with interest as other nations have continued to liberalize and in some important cases, privatize their posts.

In December 2006 the Postal Reform Law was passed to the surprise of many close in industry observers. Critics of US Postal Reform have noted its limitations. The new law does not privatize the post. Nor does it change the current process for setting labor costs (80% of postal costs) through the collective bargaining (and arbitration) system. Presidential Commission Chairman noted that the proposed reform is not “light-handed regulation”. But in spite of these perspectives, the new US Postal Reform represents a radical departure from the traditional USPS.

The proposed paper will address three questions in subject matters in which the authors have considerable knowledge and expertise: First, What is Postal Reform intended to accomplish? How might these goals (particularly customer service goals) be measured<sup>2</sup>? And, what will likely changes mean for postal management?

J. Pierce Meyers is one of a handful of individuals who are most knowledgeable about the history of the struggle for postal reform. In future years this “Congressional History” will be extremely important to regulators and to the courts in the US as well as of interest to regulators internationally<sup>3</sup>. Lawrence Buc is a widely known economic consultant who is currently working with a wide range of postal customers on matters related to the rate case. As a result he is among the most knowledgeable professionals working with customer visibility of US postal data. Robert Reisner is the former Vice President for

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<sup>1</sup> Elcano, German and Childs, “Hiding in Plain Sight”, etc. This paper picks up from the place that Elcano et. al. leaves off.

<sup>2</sup> The Rate Commission, now the Postal Regulatory Commission must address this

<sup>3</sup> Congressional History is a term of art in Administrative Procedure and the record related to the passage of the law are in the public record. But the history seen from the view of one of the close in observers will be an important contribution to that record.

Strategic Planning of the USPS where he led the development of performance metrics to comply with the Government Performance and Results Act's requirement for the development of an Annual Performance Plan<sup>4</sup>.

Economic literature includes many observations about the unintended consequences of policy actions<sup>5</sup>. US Postal Reform offers many similar possibilities. In a recent customer meeting of the USPS largest customers the clear consensus view was that "the USPS has the data, but doesn't want to publish it". While this attribution of motive may be accurate and not surprising for any large organization, the idea that the USPS already has customer performance data is simply wrong.

What's more the inside view of postal managers (a comparison of the problems that have been created by customer access to "Confirm" data with the potential problems with existing systems such as ODIS and potential future systems such as Surface Visibility) and the external view of customers are very far apart.

The postal regulator will soon be encouraged to use subpoena power to force postal management to divulge data that may not actually exist. As a result, postal regulators and managers throughout the postal world should be interested in the way in which Reform, Economic Measures, and Management Perception will interact. Future automation planning, postal policy and regulatory transformation will be shaped by the resolution of these issues.

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<sup>4</sup> The Annual Performance Plans that have been published since 1997 continue to contain the measures that were the measures that were created.

<sup>5</sup> "Clean Coal, Dirty Air", Ackerman

## **Development of competition in EU postal markets: influence of the regulatory framework on the pattern of competition**

Authors: Dr. Nick van der Lijn (lead author), Patrick de Bas, Arno Meijer

The objective of the paper is to analyse to what extent the regulatory framework in EU countries influences the business models of competitor postal companies that have entered or are likely to enter the market. Particular emphasis is given to the assessment whether the chosen liberalisation path in various countries has an impact on the business models of postal operators in the coming five to ten years or that the business models and pattern of competition in EU countries are most likely to converge after the planned full liberalisation of EU postal markets.

The paper is based on a case study analysis of the interaction of the (changes in the) regulatory framework and the pattern of competition of some of the main EU postal markets (Germany, the Netherlands, Spain and the UK). The developments in these countries are interesting to compare, given the fact that they are relative frontrunners in the liberalisation process in the EU and that there are marked differences in the chosen paths to liberalise the postal market. For example, in Spain the delivery of intra-city mail has been liberalised decades ago, in the Netherlands the delivery of addressed printed matter (including direct mail) was liberalised in 2000, in Germany many competitor postal operators have opted for a so-called D-license for delivery of value added postal services, whereas the UK has already fully liberalised its postal market in the context of a fairly recently established system of downstream access. The paper builds on and further elaborates the analysis of the development of competition in EU postal markets in ECORYS (2005).

Understanding how competition is developing and how the regulatory framework may impact the pattern of competition is of interest to policy makers, sector regulators, scholars and others interested in the postal sector. This is particularly relevant, as the liberalisation process has not yet been completed (the proposed date for the full liberalisation of EU postal markets is 1 January 2009) and there are various options and choices to make for regulating the postal sector in the medium term.

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**“Forecast uncertainty in dynamic models: an application to the demand for mail”**

C. Cazals, J.-P. Florens (IDEI, University of Toulouse),  
F. Rodriguez, S. Soteri (Royal Mail Group, U.K.)

This paper analyses the uncertainty of forecasting the demand for mail using a dynamic econometric model. Forecasting from a dynamic model is usually developed from the conditional (to the available information) means of the future values of the model explanatory variables, and the uncertainty is assumed to come only from the residual term of the estimated model. However, two other, potentially large, sources of uncertainty exist: the error on the estimation of the parameters and the error on the future evolution of explanatory (exogenous) variables.

The errors on the estimated parameters are well known (given the values of the explanatory variables) and are very often assumed to be negligible in comparison with the residual terms. However, this point needs to be analysed more carefully. Small variations on the parameter values of macro economy or time trend variables in dynamic demand for mail models are likely to affect mail volume forecasts in an important way, at least after some periods given that in autoregressive models forecast errors cumulate when the forecast period increases. The extent to which this is the case may be analysed and quantified using theoretical computations or Monte-Carlo simulation (by drawing parameters from their sample distribution) techniques.

Forecast errors associated with a given scenario due the evolution of the explanatory variables are less explicitly incorporated in the forecasting mechanism. In addition to an analysis of the sensitivity of predictions to some change in a scenario, it is useful to specify the distribution of the explanatory variables, which may be asymmetric around the mode. In this case the uncertainty associated with the explanatory variables (combined with the uncertainty of the parameters in a non linear way) added to the error term may create, when the forecast period increases, more complex distributions than the usual Normal distribution, with a larger dispersion.

It is important that postal operators and decision makers be aware of the existence and magnitude of this type of forecast uncertainty if they are to reach properly informed evidence based conclusions.

The aim of this paper is to illustrate this forecast uncertainty in dynamic models, with an application to a model of demand for mail in the UK. More precisely the model is used to simulate  $M$  samples. These samples are then used to obtain the shape of the confidence intervals obtained from the true distribution for forecasts errors, that is for the difference between “actual” values (simulated but unobserved by the econometrician) and predicted values for the considered variable. These are compared to the confidence intervals associated with the residual term from the estimated model which considers only one aspect of forecast uncertainty and so are smaller, perhaps considerably so, than those associated with the true distribution of forecast errors. The paper concludes by drawing out policy implications of the research findings.

## Micro econometric analysis of Direct Mail receivers' choice purchasing behaviour

Abstract

Sacramento Costa, ctt correios\*

Sónia Pinto, ctt correios\*

The UPU forecasts for the period up to 2008 (UPU, 2004) show that *“two thirds of public operators are anticipating a drop in the proportion of income generated by letter-post”*. The very same document gives an idea about which letter-post categories are expected to increase. More than 90% of Postal Operators of European (95%) and Industrialized (92%) Countries are expecting Advertising Items' domestic traffic to increase in the same period (UPU, 2004).

A macroeconomic analysis evidences a weak correlation between the development level, measured by the Human Development Index (HDI) of a country and the Direct Mail traffic share on total postal traffic<sup>1</sup>. The gap between this correlation and the perfect one should be searched in the fields of the *“national stereotypes and competitive levels markets, which refines and changes ... retail purchasing patterns.”* (Garnham, 2006, p.1).

The UPU Direct Mail Advisory Board (DMAB) Development Plan 2005-2008 states that *“Direct Mail markets development forms part of... Bucharest World Postal Strategy (BWPS), emphasizing the necessity of broadening the knowledge of markets and responding to customer needs – satisfying customer needs and requirements...”* (DMAB, 2005).

Modelling the purchasing patterns behaviour with a micro econometric method will be useful to Postal Operators, as well as to the stakeholders that build the Direct Mail Market.

To support the study on primary research, a survey was carried out in September 2005, with a sample of 720 individuals aged 18 years and more<sup>2</sup>.

The theoretical framework is based on Daniel L. McFadden's<sup>3</sup> description of a choice process: *“one decision-making task in a lifelong sequence, with earlier information and choices operating through experience and memory to provide context for the current decision problem, and the results of this choice feeding forward to influence future decisions...”* The choice process includes concepts of perception, preference, beliefs, experience, memory, motivation, attitudes, information, and constraints. These concepts *“appear in both economic and psychological views of decision-making, but with different views on how they work.”* (Mc Fadden, 2000, p.336).

So, in our study, the Binomial Probit Model (McFadden, 2000) was applied to customer purchase decision when a product or service is offered by direct mail. Three groups of exogenous variables were considered, representing as much as possible the dimensions that can influence this process of purchasing decision: one group of variables characterizes the individual, the second group describes his involvement with this form of advertising communication and the third one links to the product. The generic functional form of the experimental model is as follows:

$$y_J = f(X_{ij(m,n,p,r)})_J$$

where:  $J$  – observed result for each respondent,  $Y \hat{I} \{0, 1\}$ , (purchasing = 1); ( $J = 1, \dots, 720$ );  $i$  – group ( $i=1,2,3$ );  $j$  – exogenous variable ( $j=1,2, \dots, k$ );  $m, n, p, r$  – number of categories of an  $j$ - variable ( $m=1, \dots, 5$ ;  $n=1, \dots, 6$ ;  $p=1, \dots, 7$ ;  $r=1, \dots, 10$ ).

<sup>1</sup> Looking at some western countries to illustrate this thought (HDI ranking; percentage of the DM in total traffic): Norway (1; 34.3%), Luxemburg (4; 27.1%), Canada (5; 22%), Ireland (8; 22.1%), USA (10; 34.3%), Finland (13; 33.7%), Denmark (14; 12.9%), France (16; 30.3%), Germany (20; 33.5%), Spain (21; 17.6%), Portugal (27; 16.1%); source: <http://hdr.undp.org>; [www.upu.int](http://www.upu.int), 2006.

<sup>2</sup> Undertaken by IMR (Instituto de Marketing Research) for CTT-Correios.

<sup>3</sup> Nobel Prize laureate in 2000, for his work on Economic Choices.

\* The views expressed in this paper are those of the authors and do not necessarily reflect the views of CTT-Correios.

The results obtained from the logistic regression evidenced a reasonable quality. The main contributors to this came from variables like Individual Education Level, Economic Activity, Economic Environment (represented by the Region), Industry Sector that uses Direct Mail to sell a product or service, and Quality and Reliability of advertising pieces received via Direct Mail.

The improved experimental results obtained on these three dimensions will provide important guidelines to market segmentation and on how better reach consumers. Once achieved, we can expect all three Direct Mail Market players – Industry, Postal Operators and Customers – to be in a better earnings level.

This research and others of the kind will help Postal Operators to better tackle the decrease of mail volumes while increasing DM business.

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ABSTRACT

### **Substitution of Letter Mail in Different Sender-Receiver Segments**

As far as the development of addressed mail is concerned, the following trends are to be observed in many countries: B2B volume is decreasing, B2C volume is growing or at least remaining stable, and the volume of C2C is falling. What all of the above segments have in common is that the need for messaging increases at the very least in direct proportion to economic welfare. Where they differ is in the way the implementation of new technology succeeds in specific segments. It is not only a question of the economic opportunities afforded by new technology, but of the desire and ability to use it. Further, the pricing of letters can be made to vary according to the segments, which also affects the development of letter service demand.

The objective of this research is to analyse those factors that affect letter demand in different sender-receiver segments with particular attention being paid to estimating the form of substitution function required for each sector. This research is based on time series analyses for the years 1991–2007.

Substitution of letters by electronic communication is not a uniform process, not even a single  $s$ -curve,  $f_t = f_t(y)$ ,  $t = \text{time}$ ,  $y = \text{technology}$ ; rather a combination of different diffusion curves  $g_t = g_t(f_t(y_i), i = 1, \dots, n)$ , which means that the curve for substitution is reminiscent of a large corrugated  $s$ -curve. This is illustrated in the figure below.

The substitution effect in different sender-receiver segments is estimated as a totality by the demand model

$$Q_t = Q_t(g_t, P_t, K_t, T_t, S_t) = Q_t\{g_t(f_t(y_i), P_t, K_t, T_t, S_t)\}$$

where

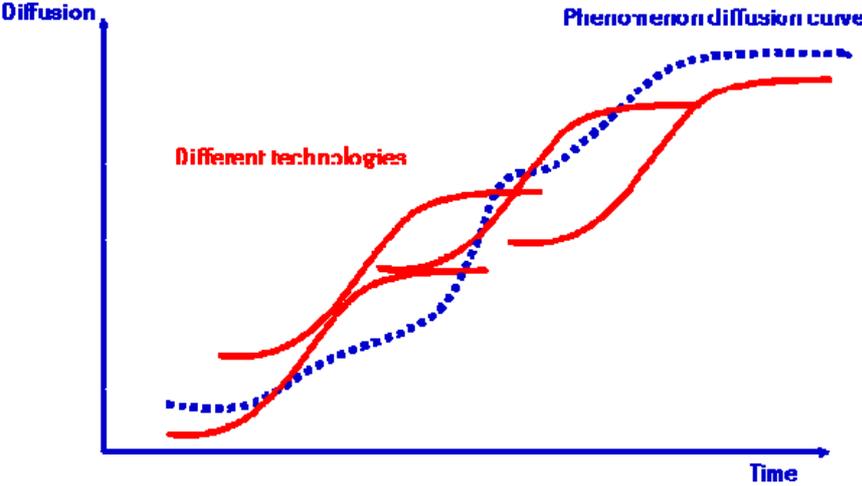
P = price of letter mail

K = price of competitive service

T = trend

S = Economic fluctuation variable

Technological trends: Substitution - Diffusion with different technologies



**The 15<sup>th</sup> Conference on Postal and Delivery Economics: CRRRI – Rutgers University**

**Semmering, Austria, May 30 – June 2, 2007**

**Abstract of Proposed Paper by Richard Eccles and Pauline Kuipers, Bird & Bird**

**Potential Effects on Postal Operators of the European Commission's Policy Review on Abuse of Dominant Position**

This proposed paper will review the likely exposure of incumbent postal operators, and possible competition regulatory opportunities for new entrant operators, concerning the competition law rules on abuse of dominant position. The European Commission is currently carrying out an in-depth review of its policy in this area. It has issued a discussion paper on exclusionary abuses, and a further discussion paper on exploitative abuses is expected during 2007, with new guidelines on both aspects expected in 2008.

Typically, incumbent postal operators are in a dominant or super-dominant position. Their prices, at least for their core letters business, are regulated. However, the rules on abuse of dominance will apply to an incumbent operator's activities to the extent that specific regulations do not apply and especially as regards competitive services outside the regulated areas.

Our proposed paper will build on the analysis of competition regulation of postal services in Europe (delivered at the 2005 conference) by reviewing the case law to date under Article 82 of the EC Treaty, including the EC decisions concerning *Deutsche Post* (interception of cross border mail and cross-subsidised predatory pricing in parcel services).

The proposed paper will discuss the types of exclusionary conduct that may be relevant to incumbent postal operators with reference to their regulated and also liberalised services, especially price-based exclusionary behaviour, including predation, bundling and margin squeezes, and also loyalty rebates (including rebates both for all purchases or incremental purchases, and whether on a generalised or individualised basis), and discuss the extent to which they should be regarded as abusive. The paper will also assess relevant exclusionary abuses such as discriminatory pricing and the extent to which should properly be regarded as an abuse, taking account of relevant competition regulatory decisions. The paper is intended to be of interest to anyone involved in strategic management of an incumbent or new entrant postal operator and to lawyers and economists.

**Richard Eccles and Pauline Kuipers**

**Bird & Bird**

**15 December 2006**

**Abstract for the 15th Conference on Postal and Delivery Economics**

**“Licensing regimes under the recent EC proposal for a Postal Directive.  
What limits beyond the proportionality test?”**

**Joost Vantomme, Director regulatory affairs, De Post NV/La Poste SA &  
Alessandra Fratini, Partner, O’Connor and Company**

Licensing systems and the associated entry conditions are an important regulatory tool and have always been under scrutiny from a regulatory perspective. These issues are even more crucial in a full-competition scenario, like the one the European Commission is proposing for the EC postal markets as of 2009.

The Postal Directive currently allows two different levels of regulatory controls depending on whether the postal activities fall outside or within the scope of the universal service. For postal activities outside the scope of the universal service, general authorisations may be introduced to the extent necessary to guarantee the “essential requirements”. For postal activities within the scope of the universal service, but outside the reserved area, authorisations or individual licences may be introduced to the extent necessary to guarantee the “essential requirements and to safeguard the universal service”. Under the Postal Directive, a Member State might also refrain from establishing authorisation procedures altogether.

Disciplines on licensing differ from Member State to Member State. The European Commission highlighted in its recent third Application Report that further harmonization of the conditions that may be introduced and the principles applicable to those conditions and procedures appear to be necessary so as to reduce unjustified barriers to the provision of services in the internal market. Some believe that a true single market for postal services may call for more harmonisation while others call for more subsidiarity.

The new proposal for a Postal Directive tabled by the European Commission and currently under discussion contains a series of provisions on licensing systems that Member States may continue to apply.

The authors analyse the current licensing conditions in most Member States and study the limits of licensing conditions in light of the principle of proportionality and associated European Community law. Taking into account the various studies for the Commission (WIK 2005, WIK 2006, Prospective study of the Commission, Impact Assessment of the Commission) and the proposed Directive (art. 9), the paper will further examine what kind of requirements and service conditions could still be imposed through licensing systems.

Finally, the paper will address policy implications and give legal guidance as to the licensing objectives and the limits of licensing conditions. An optimal combination of efficient market entry, preservation of the essential requirements and the maintenance of a high quality universal service will have to be addressed.

The paper will be primarily legal policy oriented. It will contain actual country results combined with references to case law and doctrine in the postal sector and other network industries where appropriate.

The topic of licensing schemes has not yet been addressed extensively in legal and regulatory papers, conferences, study material. In the forthcoming scenario of further liberalization, however, it will become critical for policy makers, when designing the new regulatory framework in light of the upcoming new Postal Directive.

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**APEK**

**Post and Electronic Communications  
Agency of the Republic of Slovenia**

# **ENTRY TO THE POSTAL SERVICES MARKET – SCOPE AND ROLE OF EC MERGER REGULATION**

(Antitrust and competition policy)

## **Abstract**

Author: Denis Šparaš  
Position: Market Regulation Associate  
Education: lawyer

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Position: Head of Postal Division  
Education: economist

**(1) Working title**

Entry to the postal services market - scope and role of EC Merger Regulation

**(2) Abstract**

Traditionally, the competition policy of the EC has been based on the control of undertakings behavior. While the Treaty explicitly grants the power to the Commission to apply sanctions to undertakings that cause appreciable restrictions of competition or commit abuses of dominance, it is silent about its role and the whole structure of merger and acquisition process in the common market. It was clear however from the beginnings of “European” competition policy that these operations can also cause serious competition problems. To tackle this problem Commission tried fill above mentioned gap in its early decisions (ex. *Continental Can*).

However it was clear at early stages that process of mergers and acquisitions will have to deal with some sort of legal act which will give power to the Commission to tackle the potential negative impacts of concentrations. Procedural and substantive rules of dealing with these processes changed significantly in 2004 after the adoption of Regulation 139/2004.

Postal sector in the Community is likely to move towards FMO. Possible effects this may have in various Member States and at various stages of the market has been dealt in depth by the study commissioned by the Commission (PwC, 2006). Important element of future of postal market is also the process of regulations. However when talking about the regulation we must bear in mind that not only ex ante, but also ex post regulation is important part of this process. This can be clearly seen from some of the decision of the Commission and European courts, where it has been dealt mostly with market behavior of undertakings (ex. *Hays/De Post, ASSEMPRE/Correos*).

However postal market is not just undergoing changes in the form of FMO. It is also at the stage where different business models are being developed by companies active on this market or the ones that are closely connected with it. To this end regulation of mergers and acquisitions forms an important element that has to be taken into account when developing future business model. In this regard companies on the market that are likely to merge in order to optimize efficiency elements of this process will be primarily under scrutiny of national or European merger authorities. At the Community level there have been few decisions on this matter regarding postal sector most recently one in the case of *La Poste/CVC* where Commission adopted a decision under Article 6(1)(b) of the Merger Regulation.

Paper will mainly focus on two important issues. The first one is the Merger Regulation and conditions that needs to be satisfied in order for the proposed concentration to be cleared and therefore being in the line with broad objective of creating the common market and more narrow objective of having a system of undistorted competition. The second one is the development of process of scrutiny of concentrations, which is moving from form based approach to effects based approach. In the line with this the whole chapter will be dealing only with possible impacts to the process of scrutiny of the proposed concentrations after the judgment of the Court of First Instance in *Impala* (SonyBMG joint venture) case.

Finally paper will address possible implications of above mentioned regulation and subsequent case law in postal sector with special emphasis on future of this sector under the conditions of FMO. Paper intend to summarize some basic models that could be adopted in

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order to get benefits from efficiency gains in the sector and introduce the role of ex post regulation in the future only to the extent that is connected with changes on the market that have been a result of structural changes of companies.

Methodology that will be mostly used is analysis of current framework and subsequent case law and analysis of its implementation in practice. The analysis will be interdisciplinary as it is evident that knowledge of legal and economic theory is relevant while deciding on the issue of compatibility of a concentration with a common market. The topic covered by this paper has only been partially covered by other authors and mostly not in this connection (market regulation in postal sector).

### **(3) Purpose and goals of the paper**

The purpose of the paper is to present a framework that has to be taken into account when employing business models whose result have been structural changes in companies and conditions that need to be satisfied in order for a concentration to be compatible with common market. Primarily focus will be on following questions:

1. regulatory framework for mergers and acquisitions (competition law connected with company law)
2. analysis of relevant case law of Commission and CFI and ECJ
3. impacts of CFI's decision in *Impala* case for future analysis's of mergers (role of economic analysis – modernization of implementation processes)

Goals of the paper are:

1. to present merger regulation framework and where necessary deal with company law issues
2. to present main elements of postal sector that are relevant for concentrations in postal sector
3. to present basic economic terms relevant for deciding in cases of concentrations
4. to present relevant terms and process while deciding whether a concentration can have pro- or anti-competitive effects in market
5. to present relevant Commission's decisions connected with mergers in postal sector
6. to present and analyze possible impact of decision of CFI in *Impala* case for future concentrations at European or national level

### **(4) References**

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**(4) Possible table of contest**

1 *Introduction*

2 *Merger Regulation*

2.1 Article 81 and 82 of the Treaty

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5.2 Relevant facts – future business models

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7 *Summary*

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**“Organisational Structures for Postal Operators: Some Results on Pricing and Welfare Economic Issues”**

Philippe De Donder (IDEI, University of Toulouse), Helmuth Cremer (IDEI, University of Toulouse), Paul Dudley (Royal Mail Group) and Frank Rodriguez (Royal mail Group)

**ABSTRACT**

National postal operators providing universal service typically are integrated operators where all stages of production up to and including sale to customers are contained within a single company. In some countries a number of business units may have been created within such companies and there may also be reporting arrangements for accounting and performance purposes for these business units. Following the precedent from other network industries, the organisational structures of national postal operators are likely to come under greater regulatory review and examination in the future to assess whether an alternative to the current structure may be in the public interest.

Our paper begins to examine some of the pricing and welfare economic questions raised by this area. In particular, we develop a formal economic model which seeks to understand how postal prices (including internal transfer charges), volumes, profits and associated economic welfare differ under alternative organisational structures to this prevalent model such as more formal arrangements for accounting separation between business units.

The national postal operator in our model is assumed to operate in a fully liberalised market where entry to the bulk mail market can be through access or bypass. We introduce a geographical dimension by including an urban area and a rural area where the latter has a higher delivery cost. The national postal operator is also assumed to have a requirement to offer universal service through a single piece product which is uniformly priced. Entrants, however, are assumed not find it profitable to enter this market. Some of the cases we develop in our model are welfare optimal while others follow regulatory conventions (eg EPMU) which may result in lower welfare.

We calibrate our model with stylised data to help illustrate and gain intuition from the formal results of our model. We conclude by drawing out policy and public interest implications regarding the organisational structures and pricing rules considered in our paper.

## Abstract for the 15th conference on postal and delivery economics

### ‘EFFICIENT PRICES, DELIVERY CHOICE AND PRODUCTIVITY GAINS IN A COMPETITIVE POSTAL MARKET’

AXEL GAUTIER

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In the European Union, full market opening (FMO) is now scheduled for 2009. Maintaining universal service obligations in a competitive market is a key challenge for the universal service provider. FMO will be accompanied by a change in tariff for the USP; Prices on market where competition is intense (bulk mail) are likely to decrease while prices on less competitive market segments (letters) are likely to increase in order to finance the USO.

These price changes will depend on a) the intensity of competition, b) the delivery technology of the entrants (access or bypass), c) the productivity gains achieved by the USP and d) the financial burden of the USO. In this paper, we take the USO constraint as given and we search for the efficient prices for the USP when the other three factors are endogenously determined.

Competition obviously depends on the price level and the price structure of the USP; In the model, we explicitly take into account the possibility for the USP to strategically deter bypass by setting low access prices (Billette de Villemeur *et al.* 2006, Gautier, 2007 and Bloch and Gautier, 2006); And we introduce the possibility for the USP to achieve productivity gains in its delivery network by exerting an unobservable ‘effort’ in a standard moral-hazard framework.

The productive effort exerted by the USP depends on the competitiveness of the market and on the delivery method of the competitor: the USP exerts more effort to increase the productivity of its network when the entrant bypasses. Moreover, to induce the entrant not to bypass, the USP uses both the prices and the productive effort.

In this paper, we derive analytically efficient prices and effort level for a regulated USP and we illustrate the main results with numerical simulations. We concentrate on the evolution of prices and we show that the price structure of the USP is different under access and bypass. A welfare analysis completes the results.

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# Optimal pricing in competitive two sided postal markets

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Urs Trinkner  
*Swiss Post and University of Zurich*

## ABSTRACT

Postal letters are a means of communication between two parties with at least one of them having a positive willingness to pay. Postal operators offer the service that exploits this willingness to pay. Interestingly, virtually all postal operators apply a pre-paid mechanism that goes back on Roland Hill's proposal of charging the sender-side of the market instead of the receivers. This involves the potential for the senders to bill the postage onward to the receivers. The potential varies between the various classes of mail and is essentially determined by the bargaining position between the two communicating parties. Postage for advertising mail remains on the sender-side, while postage in commercial relationships is usually - directly or indirectly - passed on to the receivers. E.g., Swiss banks increasingly bill postage for bank statements directly to their clients (i.e. the receivers)<sup>1</sup>.

The fact that mail consists of two parties communicating with each other makes the postal market two-sided. If this two-sided market is served by only one operator (as it remains the predominant regulation in most countries) the designated postal operator has the necessary bargaining power to chose the pricing mechanism of her choice (sender pays, receiver pays, or a mix between the two). In a second step, senders and receivers are able to reallocate postage by means of negotiation as mentioned above. In competitive markets, two effects could potentially lead to different optimal pricing principles: (1) the historical operator loses its market power on the sender side because of competing networks, and (2) receivers get bargaining power in terms of whom to give the right to operate their P.O. box. The latter

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<sup>1</sup> Often, the official single-piece tariff is billed instead of the reduced rates business customers usually pay.

effect could in principle yield a situation where large receivers give their P.O. box in license to the P.O. box operator paying them the most.

In our contribution, we analyze whether the traditional pricing concept (sender pays principle) remains dominant in competitive postal markets. To do so, we split the competitive postal market in a processing and delivery part, where a postal operator faces two kinds of customers: senders in the former and receivers in the latter part of the market. Based on the contributions by Armstrong (2006), Panzar (2006), and Rochet&Tirole (2003), we develop a theoretical model with endogenous (linear or two-part) pricing in either part of the market and consumers' platform choice for selected regulatory P.O. box access regimes. Thereby, we extend the analysis of a delivery flat rate by Friedli et al. (2006) to a competitive environment and assess optimum pricing schemes in market equilibrium.

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## **Abstract for the 15th Conference on Postal and Delivery Economics**

### **“Customer satisfaction as a driver for future Postal volumes”**

**P. Koppe and Ch. Bosch**

**Post Austria and Vienna University of Economics and Business Administration /  
marketmind GmbH, Vienna**

The business environment of postal companies is highly challenging. The current technological developments give rise to opportunities as well as risks. At the same time, incumbent postal companies in the European market are faced with increasing intensity of competition. The network infrastructure, which postal companies (must) provide, is capital-intensive. Consequently, the promotion of mail volumes over the next 10 years and how they are influenced by the changes mentioned above is a matter of vital importance to incumbent companies. Empirical analysis of the past illustrates the difficulty of estimating the development of mail volumes. Austrian Post has tested the influencing factors of the future volumes on the level of mail flow empirically (analysis by business sectors, recipients and mail content). Interestingly, the analysis described in last year's paper revealed that the decisive influencing factor is customer satisfaction, not e-substitution or general cost cutting measures.

In the current paper, a Structural Equation Model is employed to describe the influence of customer satisfaction on customer loyalty (operationalised as future mail volumes shipped by Austrian Post). Results help Austrian Post to develop strategies to defend their position in the market in the short run. Insights into the influences of market liberalisation on postal volumes will prove to be crucial for the company's future development.

The paper opens with an appraisal of the current situation and an abstract on possible approaches to the measurement of customer satisfaction. The core of the paper is centred on the description of the chosen measurement approach. Finally, it goes on to illustrate the challenges and implemented solutions.

Customer satisfaction was measured on two intertwined levels: “customer groups” and “service types”. For each “customer group” a measurement model is implemented including all “service types” of the Austrian Post relevant for this group (customer groups: business customers, small and middle enterprises, private customers, all relevant products in the particular target group) – a total of 8 part surveys. Each of these part models measures the satisfaction along the course of contact with the customer and is therefore able to respond to the specific traits of the particular service type. The part models were integrated into a complete model according to the allocation of sales between the groups. This complete model contains a total of 240 indicators which can be used as levers to control customer satisfaction. Overall satisfaction with Austrian Post is the model's central endogenous variable. Customer loyalty is included (assuming the complete liberalisation of the market) and implemented in the model as a construct resulting from customer satisfaction and competitive offerings. In order to solve this complex task, linear Structural Equation Models are employed. Thus, the model allows a direct calculation of the impact of service improvements on customer loyalty.

The discussion of the benefits for Austrian Post and the illustration of implemented and planned consequences are dealt with at the end of this paper.

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## **Empirical Analysis of Demanded Quality of Service in Japan's Postal Market**

Shoji Maruyama

*Japan Post*

### Abstract:

After its establishment in 2003, Japan Post Corporation has strategically endeavored to expand its parcel business, aiming to achieve a one-tenth share of the small package market. As a result of fierce competition with private operators, the quality of parcel service, comprising the postal universal service obligation (USO), has significantly improved for private and business customers. Progress in service quality has also been made in the EU mail market with the ongoing liberalization (WIK (2006)).

Japan Post is scheduled to be privatized and restructured into four business units in October 2007. After this reform, parcel service will be provided in Japan as a "freight" business rather than as a postal product, which means that parcel USO will not be imposed on the postal operator. This policy decision will be implemented under the assumption that competition in the small package market will be so widespread that universal parcel delivery will be considered to be guaranteed without mandating USO.

There have been considerable debates concerning the relationship among quality of service, liberalization and USO. As the fundamental components of USO were little modified in the recent EU Commission's proposal for the third Postal Directive, it can be expected that the USO burden will be explicitly recognized after the full market opening. As one feasible measure for dealing with this challenging possibility, Crew and Kleindorfer (2006) presented the notion of Social USO or "SUSO," that is, a relaxed USO aimed at adapting and aligning services, especially for smaller customers. The UK regulator already made a decision to exclude some bulk mail products from USO (Postcomm (2005)).

This paper describes econometric approaches for estimating how the progress of competition in the postal market has affected the quality of service demanded by customers, based on data compiled from questionnaire surveys targeting Japanese households. A discrete choice model, which is widely used in the area of telecommunications and other consumer services (Ida, Kuroda (2006)), will be constructed and estimated to analyze the demand structure of small package service. The current small package market in Japan is characterized by demands for a high level of service quality and a tendency for users to switch among delivery operators as a result of increasing competition. From the

implications of the analysis, it will be emphasized that any redesign of USO should be consistent with changes in customers' requirements and market conditions accompanying the progress of competition.

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## Abstract

“Survey of the service levels and estimation of costs regarding mail delivery in Swedish rural areas”

Authors: Karin Pettersson (The Swedish National Post and Telecom Agency), Per Jonsson (The Swedish National Post and Telecom Agency)

According to the Swedish Postal Services Act (1993:1684) there shall be a nationwide postal service whereby everybody can receive letters and other addressed items weighing at most 20 kg. The national postal operator Posten AB is obliged through the License terms and conditions to provide the universal postal service. The paper will present the results of the first nationwide survey ever of the distances between mail recipients and their letter boxes in the Swedish rural area. The Swedish National Post and Telecom Agency has, based on the results of the survey, estimated the additional cost of delivery where the maximum distance to the letter box would be 500, 1.000, or 2.000 meters. The paper will describe the method of the survey and the estimation of the costs. The survey includes, among other things, a mapping of the distances to letter boxes for all the 740.000 households along the 2.500 routes operated by rural postmen and principles for the estimation of the average cost of delivery including principles to verify these costs.

## **Abstract of Proposed Paper**

**Title: Are There Economies of Scale in Mail Processing? Getting the Answers from a Large-but-Dirty Sample**

**Authors: Lawrence Fenster, Diane Monaco, Edward S. Pearsall and John Waller**

Process-level and plant-level economies of scale are derived from production functions fit to a large-but-dirty panel sample drawn primarily from the U.S. Postal Service's (USPS's) Management Operating Data System (MODS). The sample consists of quarterly observations from FY1999 to FY2005 of man hours, piece-handlings and capital indices for various manual and machine-specific operations by shape (letters, flats and parcels) at 368 USPS processing plants.

Samples drawn from MODS are problematic because they exhibit apparent errors and anomalies at frequencies suggesting that much of the data are bad. Previous researchers have attempted to deal with the problem by using screens and Instrumental Variables (IV) estimators requiring auxiliary assumptions, additional data and non-sample information. Our research employs a novel Maximum Likelihood (ML) estimator that relies only on sample information and is consistent, asymptotically normal (with a known variance-covariance matrix), and asymptotically efficient. The estimator resembles an IV estimator with instruments constructed using the conditional probability that each observation is good or bad. It yields separate estimates of the equation parameters and error variances for the good and bad data in the sample, and an estimate of the frequency of the bad data. The ML estimator turns out to be very effective and broadly applicable as a way to deal with dirty data. It leaves parameter estimates, including the economies of scale, for the good data in the MODS sample that are extremely accurate.

Economies of scale in mail processing drive two issues that have recently divided the USPS and its regulator, the U.S. Postal Rate Commission (PRC). Since 1997, USPS has sought to convince the PRC that the marginal costs of mail processing decline with volume, however, the PRC continues to use estimates that assume that variable costs are proportional to volume. More recently, USPS has sought the approval of the PRC for models of its processing network that also employ declining marginal cost functions. The likely result of using these models will be a restructuring of the network that attempts to exploit economies of scale by consolidating operations in a smaller number of larger plants. However, there may be little to be gained by consolidation if most processing costs vary proportionally with volume.

Abstract for the 15th Conference on Postal and Delivery Economics

“Data requirements for cost modeling in a mail communication system”

L. A. Pintsov and A. Obrea  
Pitney Bowes, Inc.

One of the fundamental challenges concerning governance and operations of modern postal enterprises is cost accounting. Due to the complexity of cost accounting, it is important to separate objectively collectable data from conventions and agreements which are the object of debates about merits and demerits of different cost models. Equally, it is important to identify all possible sources of data that can be brought to bear and to estimate their reliability.

The purpose of the paper is to identify important data elements that can be objectively measured in the system-wide context. The paper attempts to identify and demonstrate the use of sources of information which are currently not available to regulators and other interested parties. An attempt is made to separate the objective elements of data required for cost accounting and to identify main system-wide sources of data that are in essence invariant to cost models.

The paper uses econometrics techniques to identify key data elements participating in typical postal cost models. As far as the authors are aware, a typical econometric research in postal cost modeling involves only sources of data internal to postal operators. The paper attempts to incorporate other potential sources of data such as mailers, recipients and consolidators.

The paper is related to previous papers by Crew and Kleindorfer, 2006 and Pintsov, Obrea and Biasi, 2006. One of the consequences of this research is a determination whether a separation of mailstream into social and business mailstreams can be made practical and reliable from a regulatory perspective.

Frequently, the postal environment is the only source of data being considered, while in fact other parties and systems may provide very valuable additional sources of data. The paper attempts to describe methods of collecting objective data from multiple sources and methods of such data correlation and analysis.

The results of the analysis presented in this paper could be used for improved clarity in managing USO obligations in a deregulated (liberated) postal market. It is expected that the paper will generate interest in view of postal market liberalization in Europe and associated non-trivial issues with fair competition and USO. Regulators, independent postal operators and mailing industry would be a primary audience for this paper. The paper is timely in light of the current issues of regulation and data requirements for fair and equitable treatment of competing postal operators.

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*When the answer matters*

## **Trade-Offs In Product Costing: the Statistical Impact of Cost Pool Formation Decisions**

**Richard Waterman, University of Pennsylvania and Alan Robinson, Analytic Business Services\***

The USPS estimates product level marginal costs as the sum of marginal costs over the set of all cost pools. This paper investigates the impact that the number of cost pools created may have on the quality of the overall marginal cost estimates.

In this paper, we summarize the costing framework that uses the marginal cost estimates provided by Bradley's formulation of Unit Volume Variable Cost, that involves the estimation of volume variable estimates for the cost pool and a distribution key to distribute costs among products within a cost pool. We then combine this formulation with a traditional statistical view of determining the quality of an estimate.

The issue of cost pool formation is important as there appears to be a natural tendency over time to create more and more cost pools in order to reduce estimation bias. This tendency most likely exists in both regulated and unregulated environments. In a regulatory environment, the reduction of **estimation bias** often becomes a predominant goal. In a marketing environment, the need for unbiased customer specific costs may trump concerns about the variance associated with those cost estimates.

In following the tendency to increase the number of cost pools, costing analysts face a standard statistical tradeoff between the bias and variance of an estimate. Slicing the data to a finer and finer degree tends to reduce bias, but the concomitant reduced sample size will typically increase variance. The tradeoff between bias and variance may become of more concern when unit volume variable costs within individual cost pools involve the combination of information from multiple statistical analyses.

These two attributes are classically traded off through the measure of the Mean Squared Error (MSE) of an estimate. This paper will examine how the mean squared error is affected by investigating two scenarios:

1. There are two cost pools, but they are erroneously combined into one.
2. There is one cost pool, and it is erroneously split into two.

The analysis of these scenarios will look at the sensitivity of the volume variability estimates to these errors, the sensitivity of the distribution key estimates to these errors, and the combined total volume variable cost and unit volume variable costs estimates. The analysis of the scenarios will be used to develop options that cost analysts can consider to split or aggregate existing cost pools.

\* Alan Robinson will present the paper.

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**The accessibility of the postal retail network and the objectives of social cohesion and economic development.**

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The accessibility of the postal retail network has been an important issue of the universal service provision for the last decade. This importance has been re-enforced in the Directive project launched by the Commission on October 2006, where the accessibility of the postal network, as a component of the universal service, contributes to promote social and territorial cohesion. Most of European countries have transposed this component through the respect, by the universal service provider, of accessibility criteria. This leads to an “oversized” retail network, as compared to the one that would have been sustained in a purely commercial objective.

The aim of this paper is to study how general economic interest is served in the best possible way through the accessibility criterion. Cohen *et al*, in recent contributions, compare the territory presence with other services such as pharmacies. Following this path, we propose here a study based on two steps. First, we analyze in France the relative accessibility to different public and commercial services (pharmacies, bakeries, schools, telephone-cabins...) compared to postal retail points, in a static way and with regards to the social and territorial cohesion objective. We then turn to a dynamic analysis of positive externalities between the services and goods provided in a given area. Our objective is to understand how the state intervention, through a combined policy of different services, can launch positive demand effects over local economy leading to a reduction of the net cost of postal territory presence in the mid term.

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# **National Postal Strategies after a Full Postal Market Opening**

**Abstract of proposed paper for 15th Conference on Postal and Delivery Economics,  
May 30th - June 2nd, 2007, Semmering, Austria**

Gonzales d'Alcantara (1)

Axel Gautier (2)

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The objective of the paper is to present and calibrate a model about the strategies followed by national postal players after Full Market Opening (as defined in the European Directive proposal). There are three national players: two Operators, the USP and the Entrant and a National Policy Maker or National Regulator. The National Regulator has the power to determine both USO and Regulatory constraints on the USP (including tariff regulation), within the setup defined by the Full Postal Market Opening, and the budgetary capacity to pay USO related subsidies needed by the USP to reach balanced accounts. The USP minimizes costs and the Entrant maximizes its profit.

The approach of the paper is to define and solve a three period game within a given Country. In the first period, within the setup defined by the Full Postal Market Opening, a given USO definition under constant pre-FMO USP tariffs is being imposed by the Regulator. An Entrant, who invests into an alternative Postal Distribution Network with a freely chosen frequency, selects its distribution zones. Resulting unit costs of the operators determine tariffs and tariff sensitive customer driven market shares. The new volumes and postal densities in the various zones then lead to new unit costs and tariffs. The equilibrium determines a subsidy to be paid by the Regulator to the USP. In a second period the Regulator assesses the budgetary weight of the subsidy he has to pay and the extent of competition reached on the National Postal Market. Either he considers the situation as satisfactory or he wants to revise the rules. He may then decide to drop the constant pre-FMO USP tariff constraint so as to allow the USP to reach her financial balance using tariff increases. This leads to a second market share distribution. Then, a third period follows, where the Regulator assesses the market shares again. He may then decide to introduce a tariff cap equal to the value of the optimal Ramsey Tariff. This will lead to a new equilibrium. The three periods have to be solved before the global solution of the dynamic game is reached.

The model presented will be based on the paper presented by G. d'Alcantara at the Bern Conference on Postal and Delivery Economics (2006). It is a further development of the model published by G. d'Alcantara and B. Amerlynck (2006) about Profitability of the Universal Postal Service Provider under Entry with Economies of Scale in Collect and Delivery. Calibrations of this National Postal Strategy model will allow grouping the countries following the impact of economies of scale and degrees of postal density on the levels of subsidies and competition reached. It is of interest to anticipate the diversity of National solutions reached in the context of the Full Market Opening as recommended in the proposed Directive of the European Commission.

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Peeking into the future: Modeling the Portuguese Postal Market in Competition<sup>1</sup>  
António Amaral, ctt correios  
Alberto Pimenta, ctt correios

One of the major issues in the Postal Community nowadays is how to evaluate properly (and before the fact) the impact of liberalization of the Postal Market - that will take place in the near term - for all those involved (consumers, postal operators and regulator). In particular, there is a need to quantify the impact of this structural change for the Universal Service Provider (USP). In Europe, moving on a fast pace towards complete liberalization, this topic fills the strategic agendas of all major Postal Operators, who bear the Universal Service Provision responsibility while striving to maintain profits and performance that ensures their economic sustainability. Most of them are state-owned corporations with a long heritage, heavy infrastructure and stiff social responsibility, reducing the scope of management agility.

To address these issues, many initiatives have been introduced: new products were developed (most of them depending on new information technologies, seeking opportunities when before they were considered insurmountable threats); policies aimed at cost efficiency according to the new demand standards; major focus is given to corporate reputation, in an attempt to increase brand value and customer loyalty. Still, entry impact continues to be a hot topic among incumbent postal operators.

Different entry models, subject to the discretion and rational decisions of prospective entrants, may induce different market outcomes. Other regulatory pre-conditions (e.g. uniform pricing) make the challenge of assuring the USP's profitability and his own ability to sustain the Universal Service difficult.

In its particular case, the Portuguese Postal market is a small, highly concentrated market, with heterogeneous geographic and socio-demographic conditions that determine the cost of postal service provision throughout the territory. Thus, there are only a few entry models that may present themselves as sustainable alternatives to the monopolistic provision of service.

This paper will present a simple dynamic framework. It will develop an economic model that introduces the problem of optimal strategy choice in a two-stage game. Hence, duopolistic competition will be assumed allowing identification of possible convergence conditions and, ultimate market outcomes in equilibrium (prices, market shares, social welfare, cost of the universal service and its financial support), after both entrant and incumbent are allowed to adjust their strategies. At this stage asymmetric information

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<sup>1</sup> ‡ The views expressed in this paper are those of the authors and do not necessarily reflect the views of ctt correios.

between stakeholders will be introduced as a pre-condition for the implementation of the optimal strategy. Furthermore, the impact of different degrees of freedom in formulating strategies will be tested, including non-uniform pricing vs. uniform pricing and regulatory standards.

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## ABSTRACT

### **Economic Imperatives That Drive Further De-averaging of Postal Rates**

By

John Haldi & William J. Olson

Once a postal administration (“PA”) opens the door to access pricing, rate de-averaging becomes a self-perpetuating process driven by evolving competition and economic imperatives.

**Objectives.** To analyze driving forces in postal pricing and critique alternative price setting approaches.

**Approach.** Examine recent trends in rate setting in the United States as a case study to illustrate both right and wrong ways for incumbent PAs to address competitive pressures.

**Contribution.** Sophisticated vendors search continuously for ways to underprice the PA, and further rate de-averaging by the incumbent is regarded here as the most appropriate response. Active competition coupled with proper pricing also is seen as the most effective way to have postal services provided at lowest-combined cost. The paper also will recommend shifting focus from speculation about “costs avoided” (costs PAs do not incur for mail which they are not asked to handle) to proper measurement of “costs incurred” (costs to process and deliver mail that is deposited with them by their customers).

**Literature.** This paper builds on two papers by the same authors. A paper on worksharing (Toledo, 2003) showed that revenues from implicit prices (“discounts”) for upstream activities failed by a substantial margin to cover the aggregate costs incurred to process mail in the system. A second paper on enhancing competition (Antwerp, 2005) showed that unbundling the upstream portion of a postal network and subjecting the activities therein to full competition would necessitate (i) further de-averaging of many existing rates, and (ii) increases in some rates above existing levels in order for the upstream portion to achieve financial breakeven. Panzar (Berne, 2006) shows that heterogeneous mailstreams defy a simple one-size-fits-all approach to pricing.

**Audience.** Intended primarily for PA management and regulators, but also may be of interest to those concerned with optimal pricing strategy.

**Timeliness.** In Europe, the deadline for fully opening postal markets to competition is approaching. In the United States, Congress recently passed the Postal Accountability and Enhancement Act, which will establish a new regime for rate setting. A required flurry of rulemakings by the new Postal Regulatory Commission will seek out the most appropriate pricing approaches for a modern postal system.

Abstract for the 15<sup>th</sup> Conference on Postal and Delivery Economics

“Negotiated Service Agreements in a Regulated Post”

Matthew Robinson - Postal Rate Commission,

Margaret Cigno – Postal Rate Commission,

JP Klingenberg – Consultant

With internet diversion and an otherwise declining First-Class Mail volume, there has been significant pressure for the U.S. Postal Service to raise revenues and cut costs with new, creative methods. In this environment, five Negotiated Service Agreements (NSA) have been implemented as of December 2006. While there has been significant critical review of the current NSA regulatory process, this paper will review data and policy behind past NSAs, as well as suggest how NSAs can achieve their full potential in the future.

With the mandated data reports provided by the Postal Service containing the results of existing NSAs, meaningful analysis can be performed. This paper will use several economic tools to review this data, most significantly an analysis of customer volume response to discount incentives. Furthermore, it will include a full review of non-volume effects of NSAs, including cost-reducing changes in mailer behavior. This will represent the first comprehensive post hoc review of the NSA program. The paper will also analyze potential alternative models for achieving the full benefits of NSAs in the future.

The new regulatory approach that the recently passed reform legislation will employ heightens the value to the postal community in considering the possible future direction of NSAs. Given the importance of maintaining the viability of the Postal Service, and the perspective of many in the postal sector concerning NSAs, a quantitative, empirically based discussion of past and future NSAs will be of interest to anyone concerned postal policy.

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In the march for liberalization of monopolistic industries, regulators in recent years encouraged entry of new firms into segments of production that were not subject to economies of scale. In the case of mail delivery, since all mail must be collected and sorted before it can be put into the monopolistic delivery network, the policy issue is who should be collecting and sorting the mail? The two possibilities are:

1. The incumbent provider of the end-to-end mail service i.e., USPS.
2. The mailer (the entrant) who will then participate in work-sharing.

The main objective of this paper is to identify the socially efficient discount for work-sharing in the presence of mail heterogeneity. The socially efficient work-sharing discount is that one which will minimize the total cost of mail sorting when the incumbent and entrant might have different cost advantages. Similarly to the current practice, the paper considers the limits of a single discount to generate the best solution. The paper also considers the impact of the discounts on the gross and the net revenue of the incumbent. Of special interest are the cases where the discounts introduce inefficiencies in the form ‘over payment’ for work-sharing. These are the cases where the total dollar value of discounts made by the incumbent exceeds the total avoided cost of the work-sharing and thus it includes a ‘subsidy’ to the mailer. In the last section of the paper, the heterogeneity of mailers is introduced and the optimal discount for work-sharing is considered.

When the heterogeneity of mail affects the costs of collecting and sorting the discussion about work-sharing should consider closely the following two specific topics:

- I. On the social cost it should examine the cost advantage of the different producers.
- II. On the private incentive it should clearly and directly examine the implications of the discount on the revenue losses of the incumbent.

The model in this paper put together some of foundations for such examination. The most important examination is for the regulator to answer to the empirical question of what is the state of the world in terms of which producer own the cost advantage. When the main objective of the regulator is to increase liberalization in the postal service industry, the choice of the discount for work-sharing strongly depends on the state of the world.

The regulator faces the real risk that by choosing the wrong \$ discount for the work-share it might “over-support” the cost of collecting and sorting mail by the entrant. Since this support is “financed” by the loss of revenue to the incumbent this might call for a raise in the price of end-to-end mail and redistribute the burden towards the small mailers.

The model in this paper assumes a full and free information environment where the regulator knows everything. It is somewhat more natural to assume that regulator have better access to information of the cost function of the incumbent (the USPS is an heavily regulated agency). At the same time it is somewhat harder to expect the regulator to have sufficient information about the cost structure of the entrant. Under such asymmetry in information, one possible remedy to this problem is to have a work-sharing a menu of

discounts for each heterogeneity group. This menu should be the incumbent's avoided cost. When this menu is used and when the entrant is maximizing his profit his participation rule will always lead to the socially optimal allocation of collecting and sorting. Although using the incumbent's avoided costs as the discount rule provide for the socially efficient solutions to all cases, it does not ensure the minimization of the transfer payments to the entrant. Clearly, the objective of minimizing the social costs of collecting and sorting mail cannot be reached by using the average level of the avoided costs as the discount for work-sharing.

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**Social costs and benefits of universal service obligations  
in the postal market**

by

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The universal service obligation (USO) is a cornerstone of regulatory policy in the postal sector. In the EU, where the sector is headed towards full liberalization, the USO is the major argument used to advocate some residual regulation. In the postal sector, like in many other network industries, universal service was historically provided by a monopolistic public or regulated operator. While the need for monopoly protection has been increasingly disputed, the very idea of universal service has remained relatively uncontested during the early stages of the liberalization process. The debate was not that much about the appropriate extent of the USO but about the most efficient (or least costly) way to make it competitively neutral, or at least as compatible as possible with competition. This in itself is a challenging question.

More recently, however, the USO in itself has increasingly been questioned. The question is whether the social benefits associated with the USO are significant enough to justify its cost and in particular the impediment to competition it often implies. The spectacular development of electronic communications is likely to further fuel this debate.

To ensure a sound design of the future regulatory context in the postal sector, it is important not to restrict this debate to political or ideological considerations. The underlying economic aspects are of crucial importance and have to be given thorough consideration. While there are some papers in the literature that deal with this issue, it appears fair to say that most of the contributions on USO have concentrated on the

“how” (to implement) rather than on the “why” (to impose it and to what extent). This is true for all network industries but even more so for the postal sector.

This paper provides a detailed analysis of the benefits and costs of the USO in the postal sector. We present and assess alternative economic justifications of the USO. These include the idea that a USO may be used as a remedy for network externalities, that a USO is a form of redistributive pricing policy, that it can be a channel to supply a public good or an instrument of regional policy. Last but not least we also argue that a USO can be the outcome of a political economy process.

Amongst these, the redistributive pricing argument is probably the most unexpected one and needs some further elaboration. Prices are referred to as “redistributive” when they are not solely set according to efficiency considerations. We argue that USO is first and foremost a constraint on pricing; the obligation to provide service without an affordable pricing requirement would be an empty constraint. We show that USO may be an optimal second best policy, and that this is true even within the sender pays context of the postal sector. We also identify the (social) costs of USO and suggest some avenues along which a formal cost benefit analysis of USO can be carried out.

Another aspect that will be explored is the role of the postal network as “intermediary” between firms and consumers (who interact through the “platform” provided by the postal network). This is related to the notion of network externality that has traditionally been used to justify USOs in telecommunications. However, the recent literature on two sided markets has taken a fresh look at these forms of interactions. Specifically, it has brought together the notions of usage and membership externalities and studied their implications on the pricing rules. One of the messages that has emerged from this literature is that “membership fees” on one side of the market may be below cost (or even negative). We shall examine if and to what extent the view of the postal network as a two sided market can provide a rationale for USO.

Abstract for the 15th Conference on Postal and Delivery Economics

“Universal service provision by an efficient USP: the dynamics of USO funding.

J.S.M. Geeraerts a.o.

TNT

The European Commission has published its proposals for full market opening of the European postal sector. The debate on the liberalisation of the European postal market puts much emphasis on the financial sustainability of the universal service obligation after full liberalisation. Multiple studies have been published on this subject, outlining the cost drivers and elaborating on financing models. However, few studies have quantified the actual cost of the USO. It has been argued that a social Universal Service Obligation (SUSO) could be sufficient to guarantee required service levels for consumers and small and medium sized businesses.

In order to assess the costs of a SUSO in a rural country we have performed a study called Ruralis. Ruralis estimates the costs of a SUSO for an efficient USP in a country with strong rural characteristics. The study concludes that the costs of the SUSO in Ruralis are not far above the average stamp price in Europe. In other words, it is concluded that a SUSO could sustain itself using affordable stamp prices.

The implications are far reaching. Most net costs incurred by former incumbents over the coming years, if any, will most likely not be generated because of the funding of the USO nor volume loss incurred by competition but because of their transition to an efficient operator. Consequently funding of the transition and funding of the USO should be treated as two separate issues.

We applied the following procedure to arrive at this result

- Step 1: Define Ruralis with a SUSO
- Step 2: Define an organisational set up that would do the job.
- Step 3: Design a postal Greenfield infrastructure for this imaginary country and its SUSO.
- Step 4: Model and simulate the number of FTE required and costs.

#### Step 1: Ruralis and SUSO

We first define an imaginary country: Ruralis, a large country with a small population and low postal density. For this country we define a SUSO. The SUSO demands a 5 day a week 24 hour mail collection and delivery system with an accessible system of letterboxes...

#### Step 2: Organisational set up

We focus on the execution of mail delivery services. We organise the SUSO as a stand alone operator. Retail and parcel activities are considered to be provided by standalone operators. Consequently the organisation of the SUSP has hardly any complexity. No additional delivery services are offered. An efficient SUSP will have market conform labour costs.

#### Step 3: Greenfield infrastructure

We design a Greenfield postal infrastructure that is adequate to execute the SUSO. A strongly focussed collection mechanism is required and only a limited number of sorting centres is needed. Delivery only concerns single piece mail items and can be executed in a cost efficient way.

#### Step 4: Modelling en simulation

The main processes are modelled in a volume dynamic way using industry norms. As such we developed separate models for the different activities such as letterbox collection, collection from post offices, transport to sorting centres, sorting, transport between sorting centres and transport to delivery hubs, preparation and delivery.

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## **Abstract for the 15th Annual Conference on Postal and Delivery Economics**

### **Funding universal service obligations in the postal sector**

**Authors: Derek Holt, Leonardo Mautino and Felipe Florez-Duncan (Oxera)**

The latest proposals by the European Commission confirm that the European postal market will be fully open by January 1st 2009. At the same time, the Commission considers it appropriate that the universal services be maintained in full.

In the context of further market liberalisation in the postal sector, the issue of compatibility between competition and the provision of universal services raises a number of regulatory policy questions that need to be addressed before the market is further liberalised. One of those key issues is how the provision of the universal service should be financed.

A number of funding mechanisms have been adopted in other sectors with universal service-type obligations, which have also been suggested by the European Commission as alternatives to the reserved area for the postal sector to finance any required net cost of the USO.

However, the fact that some funding mechanisms have worked well in other sectors does not necessarily mean that they could work equally well in the postal sector. Not only may the specificities of the postal sector condition the applicability of a given mechanism, but also the characteristics of a given national market may further influence the relevance of a mechanism as a means to safeguard the provision of the universal service. Therefore, how the USO in the postal sector may be funded in a further liberalised market is still a challenging question that deserves further consideration.

This paper assesses several mechanisms that could be used to fund the provision of the universal service obligations (USO) in the postal sector, include compensation funds of various forms, pay-or-play, access charge uplifts, and competitive tendering, among others. The paper defines a set of criteria that may influence the relevance of a mechanism to fund the USO, including whether the mechanism promotes efficiency, ensures fair competition, and whether it is proportional, transparent and can be implemented in practice. These criteria are used to assess the different generic funding mechanisms and ultimately to determine their applicability to the postal sector. The paper also considers generic postal-specific and market-specific characteristics that are likely to influence the relevance of a given mechanism. The assessment of each mechanism takes account of a comprehensive academic literature review, as well as an extensive review of the experience with universal service-type obligations in the postal sector and in other sectors (ie, energy, telecoms, railways and air transport).