20th Conference on Postal and Delivery Economics

May 30th - June 2nd, 2012
Brighton, U.K.

Presented by
CENTER FOR RESEARCH IN REGULATED INDUSTRIES
Rutgers Business School – Newark and New Brunswick

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Swiss Economics
20th Conference on Postal and Delivery Economics

**Wednesday, May 30, 2012**

4:30 - 7:00  Registration
6:00  Reception
7:00  Welcome and Introduction to Conference: Michael A. Crew
      Dinner & Speech: Moya Greene - Chief Executive Officer, Royal Mail Group

**Thursday, May 31, 2012**

7:00  Breakfast
9:00 - 10:30  **Plenary Session**
      **LESSONS FOR THE FUTURE**
      Chair: Michael A. Crew
      Commentary: Stephen Littlechild & Luis Jimenez
      **Jeffrey Colvin, Michael Bradley & Mary Kay Perkins:** What’s Past is Prologue: Understanding Developments in North American Postal Markets
      **Frank Rodriguez:** The Postal Economy in the UK and Rutgers Conferences Since 1990: A Review of Developments and Economic Themes
      **Joelle Toledano:** Status of the Postal Service Twenty Years After the Green Paper: A Franco-European Perspective

10:30 - 10:50  Coffee Break
10:50 - 12:20  **Concurrent Sessions**
      **TRANSACTIONAL MAIL DEMAND**
      Chair: George Kuehnbaum
      Discussants: Margaret Cigno & Patrice Muller
      **Philipppe De Donder, Helmuth Cremer, Paul Dudley & Frank Rodriguez:** The Choice Between Mail and Digital in the Provision of Financial Services: A Double Hotelling Approach
      **Frederique Feve, Jean-Pierre Florens & Soterios Soteri:** Are Letter Price Elasticities for Higher than Econometricians Think?
      **Leticia Veruete-McKay, Rob Sheldon, Peter Burge & Alison Lawrence:** Electronic Substitution and Postal Price Elasticities: A Customer Market Approach

12:20 - 1:40  Lunch
1:40 - 2:40  **Concurrent Sessions**
      **USO IN DIGITAL AGE**
      Chair: Päivi Rokkanen
      Discussants: Tarjei Weseth & Ian Streule
      **Christian Jaag, Urs Trinkner & Andreas Haller:** Defining and Financing an Intermodal USO
      **Gennaro Scarfiglieri, Marcello Cuomo, Tommaso Nardone & Alberto Rovero:** Electronic Substitution and USO Scope Definition

**EU LEGAL REFORM**
      Chair: Joanne Winship
      Discussants: Joost Vantomme & Rita Filipe Silva
      **Alessandra Fratini:** The Proposed Reform of EU Rules on Public Procurement: A Postal Sector’s Perspective
      **Damien Geradin & Christos Malamataris:** 2012 Framework on Public Compensation for SGEIs Implications for the Postal Sector

**ESTIMATION METHODOLOGIES**
      Chair: Michael J. Shinay
      Discussants: Alan Horncastle
      **Catherine Cazals, Jean-Pierre Florens, L. Simar & L. Van Kellegom:** Frontier Estimation and Environmental Variables
      **Maria Rita Pierleoni & Stefano Gori:** Efficiency Analysis of the Main Postal Operators: A Comparison between United States and Europe
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Thursday, May 31, 2012 (Continued)

2:45 - 3:45  **PARCELS**  *Empress Room*
Chair: Sue Whalley  
Discussants: Meloria Meschi, Claire Borsenberger, Sébastien Bréville & Aurélie Dehais; Price Comparisons in the Parcel Industry: A New Approach Based on the Hedonic Price Theory, Claire Borsenberger, Emmanuelle Ligouzat, Marine Oddo & Philippe Regnard: The Impact of E-Commerce and ICT on Parcel Operators’ Activity

3:45  Break
7:00  Reception
8:00  Dinner & Speech: Stuart McIntosh – Group Director, Competition Group, Ofcom

8:00 – 10:30  **Concurrent Sessions**

**FORCASTING MAIL DEMAND**  *Empress Room*
Chair: Paul C. Smith  
Andy S. Pearsall, Margaret M. Cigno & Elena S. Patel: Estimates of U.S. Postal Demand Elasticities Derived from a Random-Coefficient Discrete Choice Normal Model

10:30 - 10:50  Coffee Break

10:50 - 12:20  **Concurrent Sessions**

**USO NETWORK**  *Empress Room*
Chair: John Fletcher  
Discussants: Helen Smith & Sarah Ryan, Lionel Janin, François Lé, Racha Sahly & Olivier Salesse: Assessment and Implications of Economies of Scale and Economies of Scope within Postal Delivery, John P. Klingenberg, Lyudmila Bzhilyanskaya & Michael Ravnitzky: Optimization of the United States Postal Retail Network by Applying GIS and Econometric Tools, Henrik B. Okholm & Anna Müller: Changes in Demand- The Cost of Not Adapting the USO

2:45 - 3:45  **STRATEGIC CONSIDERATIONS**  *Alexandra Room*
Chair: Rob Sheldon  
Discussants: Lawrence G. Buc & Geoff Bickerton, Norma Nieto & Adam Houck: The Upside to Downsizing: Measuring the Environmental Benefit of Right-Sizing the U.S. Postal Service’s Operations

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

**BETTER REGULATION**  *Alexandra Room*
Chair: Stephen Agar  

10:30 - 10:50  Coffee Break

10:50 - 12:20  **Concurrent Sessions**

**INTERNATIONAL MAIL**  *Alexandra Room*
Chair: Thomas Baldry  
## 20th Conference on Postal and Delivery Economics

### Friday, June 1, 2012 (Continued)

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<td>12:20 - 1:40</td>
<td>Lunch</td>
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<td><strong>Concurrent Sessions</strong></td>
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<td>HUMAN RESOURCES</td>
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<td>Dominique Bailly</td>
<td>Jan Bart Henry, Stephen De Matteo, Natalie Jacottet, John Baldwin, Steve Fitzpatrick, Emmanuel de Lange</td>
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<td>INNOVATIVE PRICING</td>
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<td>Alexandra Room</td>
<td>Jeanne Golay</td>
<td>Siôn Jones, Helmuth Cremer, Claire Borsenberger, Philippe De Donder, Sébastien Lécou, Denis Joram</td>
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<td>POSTAL CHALLENGES</td>
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<td>Empress Room</td>
<td>Pekka Leskinen</td>
<td>Kirk Kaneer, Benjamin Gough, Richard Bradley, Phil Burns, George Houpis, Steven Tokar, Katherine Steinhoff, Geoff Bickerton</td>
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<td>STRATEGIC DIVERSIFICATION</td>
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<td>Alexandra Room</td>
<td>Michael Scanlon</td>
<td>Sven Heitzler, Alain Roset, David Levy, Brendan H. Levy</td>
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2:45 – 3:45

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<td>Reception</td>
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<td>8:00 –</td>
<td>Dinner &amp; Speech: <strong>Nick Wells, Chief Executive, TNT Post UK</strong></td>
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### Saturday, June 2, 2012

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<td>7:00</td>
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<td>9:00 - 10:35</td>
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<td>EX POST REGULATION</td>
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<td>Empress Room</td>
<td>Mary Kay Perkins</td>
<td>Joakim Levin, Nicola Shorland, Leonardo Mautino, Paul Dudley, J. Pettyman, F. Heagney</td>
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<td>MEASURING PREFERENCES</td>
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<td>Alexandra Room</td>
<td>Robert Hammond</td>
<td>Leon Pintsov, Stephen DeMatteo, Kari Elkela, Heikki Nikali, Charlene Rohr, Urs Trinkner, Alison Lawrence, Chong Woo Kim, Dimitris Potoglou, Roh Sheldon</td>
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<td>10:35-11:10</td>
<td>Coffee Break</td>
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11:10-12:45  **Concurrent Sessions**
GOVERNANCE
Chair: Stuart Holder
Discussants: Robert Campbell & William E. Kovacic
James I. Campbell Jr.: A New Governance Model for the U.S. Postal Service
Michael A. Crew & Paul R. Kleindorfer: Privatization of Postal Operators: Old Arguments and New Realities
Richard Eccles: The UK Postal Services Act 2011

FUTURE REGULATION
Chair: Hans-Peter Teufers
Discussants: Wolfgang Pickavé
Ralf Wojtek: Year 5 After Full Liberalization: Is the Postal Service in Germany a Natural Monopoly After All?
Annegret Groebel, Martin Balzer & Tobias Katzschmann: Recent Ex-ante and Ex-post Price Regulation Decisions in the German Postal Market
Martin Maegli & Christian Jaag: Competition and the Social Cost of Regulation in the Postal Sector

12:40- Lunch (Conference Ends)

POSTAL AND DELIVERY ECONOMICS PUBLICATIONS
The following edited books resulted from Previous CRRI Postal Events:

- Reinventing the Postal Sector in an Electronic Age, edited by M.A. Crew and P.R. Kleindorfer, Edward Elgar, 2010
- Heightening Competition in the Postal and Delivery Sector, edited by M.A. Crew and P.R. Kleindorfer, Edward Elgar, 2009
- Competition and Regulation in the Postal and Delivery Sector, edited by M.A. Crew and P.R. Kleindorfer, Edward Elgar, 2008
- Liberalization of the Postal and Delivery Sector, edited by M.A. Crew and P.R. Kleindorfer, Edward Elgar, 2007
- Progress toward Liberalization of the Postal and Delivery Sector, edited by M.A. Crew and P.R. Kleindorfer, Springer, 2006

The following are texts on postal economics:


These books are published by Springer and Edward Elgar. For information on ordering the books is available at either www.springeronline.com or http://www.e-elgar.co.uk/.
# 20th Conference on Postal and Delivery Economics

## Conference Staff

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<thead>
<tr>
<th>Role</th>
<th>Name and Affiliation</th>
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<tbody>
<tr>
<td>Professor</td>
<td>Michael A. Crew, Director &amp; CRRI Professor</td>
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<tr>
<td>Conference Chair</td>
<td>Rosemarie Martinez, Assistant Director—CRRI, Center for Research in Regulated Industries</td>
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<tr>
<td>Conference Administrator</td>
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<tr>
<td>Conference Chair</td>
<td>Professor Paul R. Kleindorfer, Conference Co-Chair</td>
</tr>
<tr>
<td></td>
<td>Anheuser Busch Professor of Management Science, Emeritus, The Wharton School of the University of Pennsylvania, and Distinguished Research Professor, INSEAD</td>
</tr>
<tr>
<td>Email</td>
<td><a href="mailto:kleindorfer@wharton.upenn.edu">kleindorfer@wharton.upenn.edu</a></td>
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## CRRI

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 thirty years of experience providing research, instruction, conferences, 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 & Chairs

<table>
<thead>
<tr>
<th>Name</th>
<th>Affiliation</th>
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<tbody>
<tr>
<td>Stephen Agar</td>
<td>Director of Regulated Business, Royal Mail</td>
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<tr>
<td>Torsti Alhava</td>
<td>Communications Market Specialist, Finnish Communications Regulatory Authority (FICORA)</td>
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<tr>
<td>José Ansón</td>
<td>Economist, Universal Postal Union</td>
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<tr>
<td>Dominique Bailly</td>
<td>Director of HR Strategy Management, La Poste</td>
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<tr>
<td>Thomas Baldry</td>
<td>Senior Vice President, Export/Import Classic, Global Mail Operations, Deutsche Post DHL</td>
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<tr>
<td>Martin Balzer</td>
<td>Federal Network Agency</td>
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<tr>
<td>Geoff Bickerton</td>
<td>Research Director, Canadian Union of Postal Workers</td>
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<tr>
<td>Claire Borsenberger</td>
<td>Economist, La Poste – European and National Regulation Division</td>
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<td>Bernhard Bukove</td>
<td>Director, Intecompany Pricing &amp; Regulation, International Post Corporation</td>
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<td>Phil Burns</td>
<td>Director, Frontier Economics</td>
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<tr>
<td>Lawrence G. Buc</td>
<td>President, SLS Consulting, Inc.</td>
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<tr>
<td>Lyudmila Y. Bzhilyanskaya</td>
<td>Ph.D., Sr. Econometrician, Postal Regulatory Commission</td>
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<tr>
<td>James I. Campbell, Jr.</td>
<td>Attorney, Office of James I. Campbell Jr.</td>
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<tr>
<td>Robert Campbell</td>
<td>President and Vice-Chancellor, Mount Allison University</td>
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<tr>
<td>Catherine Canals</td>
<td>Professor, Université Toulouse, TSE &amp; IDEI</td>
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<tr>
<td>Margaret Cigno</td>
<td>Director, Office of Accountability and Compliance, US Postal Regulatory Commission</td>
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<tr>
<td>Jeff Colvin</td>
<td>Director, Finance and Operations, Risk Analysis Research Center, Office of Inspector General, United States Postal Service</td>
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<td>helmuth Cremer</td>
<td>Professor of Economics, IDEI Toulouse School of Economics</td>
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<td>Director and CRRI Professor of Regulatory Economics, Rutgers University</td>
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<td>Stephen De Matteo</td>
<td>Post &amp; Logistics Director, UNI Global Union</td>
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<tr>
<td>Alex Dieke</td>
<td>Head of Department, WIK GmbH</td>
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<tr>
<td>Paul Dudley</td>
<td>Head of Regulatory Analysis, Royal Mail Group</td>
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<td>Richard Eccles</td>
<td>Partner, Bird &amp; Bird LLP</td>
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<td>Kari Elkelä</td>
<td>Development Manager, Itella Corporation</td>
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<td>Frédérique Feve</td>
<td>Researcher, IDEI – Université des Sciences Sociales</td>
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<td>John Fletcher</td>
<td>Director, KPMG London</td>
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<td>Felipe Florez-Duncan</td>
<td>Managing Consultant, Oxera</td>
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<tr>
<td>Alessandra Fratini</td>
<td>Partner, FratiniVergano - European Lawyers</td>
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<tr>
<td>Damien Geradin</td>
<td>Professor of competition law &amp; economics, Tilburg University; partner, Covington &amp; Burling, Brussels</td>
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<tr>
<td>Jeanne Golay</td>
<td>Head of Regulatory Policy, Office of Utility Regulation, Guernsey, Channel Islands</td>
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<td>Daniel Gordon</td>
<td>Competition Policy Director, Ofcom</td>
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<tr>
<td>Benjamin Gough</td>
<td>Policy Advocate, Consumer Focus</td>
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<td>Head of Department, Federal Network Agency</td>
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<td>Robert Hammond</td>
<td>Director of Postal Policy and Regulation, Consumer Focus</td>
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<td>John Hearn</td>
<td>Manager Postal Liberalization, ComReg</td>
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<td>Sven Heitzler</td>
<td>Management Consultant, Detecom International GmbH</td>
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<td>Jan Bart Henry</td>
<td>Head of EU Affairs, Public Affairs, PostNL</td>
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<tr>
<td>Stuart Holder</td>
<td>Associate Director, NERA Economic Consulting</td>
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<td>CWU UK/Ireland</td>
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<tr>
<td>Kirk Kame</td>
<td>Economist, USPS-OIG</td>
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<tr>
<td>Tobias Katschmann</td>
<td>Deputy Head of Section International Post Relations and License Monitoring, Federal Network Agency</td>
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<tr>
<td>Paul R. Kleindorfer</td>
<td>Professor Emeritus, University of Pennsylvania and Distinguished Research Professor, INSEAD</td>
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<td>J.P. Klingenberg</td>
<td>Economist, Postal Regulatory Commission</td>
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<td>Peter Koppe</td>
<td>Managing Director, Koppe Consulting</td>
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<td>William E. Kovacic</td>
<td>Professor of Government Contracts Law, George Washington University</td>
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<td>Margaux Meidinger</td>
<td>Project Manager International HR Affairs, La Poste</td>
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<tr>
<td>John Nankervis</td>
<td>Professor in Finance, Essex Business School, University Of Essex</td>
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**HOTEL INFORMATION**

The conference will be held in Brighton, U.K. The conference site is:

The Grand Brighton
97-99 King’s Road
Brighton, BN1 2FW United Kingdom

If you are staying at The Grand Brighton, it is necessary to make your hotel reservations directly with hotel via the hotels reservations team by calling **T: 044 1273 224300**. Select **option 1** and quote code: **CRR1300512** in your communication. All rooms are subject to payment on booking and are NON-REFUNDABLE. Please make your reservations only through the hotel and not through reservation services/travel agencies.

The Conference rates including VAT (20%) run from (for the American plan) £192.00 single to £336.00 for double including meals (Breakfast, Lunch & Dinner). The European plan including VAT runs from £144.00 for the single room and £156.00 for the double. This plan includes breakfast ONLY. The Overnight Spouse Rates including VAT are £70.00 (Breakfast, Lunch & Dinner), £50.00 (Breakfast & Dinner), and £20.00 (Breakfast). The deadline for reservations is **April 16, 2012**. However, as hotel space is limited it may fill earlier than April 16, 2012.

**FEES AND EXPENSES**

- A registration fee of $1,500 is payable to Rutgers University.
- Food and lodging at the Conference are not included in the registration fee. Breakfast, lunch and dinner are included in the rates for lodging. All persons that do not stay at the either the hotel will be required to pay for meals separately.
- The conference fee is waived for a limited number of employees of sponsoring organizations.
- Registered participants will be provided with
  - 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 7 months after the conference).

Please forward the Registration Form to Rosemarie Martinez at:
Center for Research in Regulated Industries, Rutgers University
1 Washington Park, Room 1104, Newark, NJ 07102-1897, USA
Phone: 973-353-5761
Fax: 973-353-1348 Email: crri@business.rutgers.edu

**REGISTRATION FORM: 20th Conference on Postal and Delivery Economics**

Name: ____________________________________________ Title: _______________________

Organization: ________________________________________________________________

Complete Address: _____________________________________________________________

Telephone: __________________ Fax: __________________

Email: _____________________________________________________________

**Billing Information:**

___ Employee of sponsoring organization—fee may be waived

___ Payment of $1,500 enclosed in U.S. Dollars payable to Rutgers University

___ Credit Card: ___ VISA ___ MC  Exp. ____/____

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Send invoice to___________________________________________________________

**CANCELLATION POLICY:** Until **April 18, 2012** cancellation is allowed (except for speakers, chairs, and discussants) without penalty and refunds will be provided in full. After this date, the indicated fee is due in full
whether or not the participant actually attends. Substitutions may be made at any time.

**Signature of Participant:** ________________________________
Ideas matter. Research on postal economics, whether presented in regulatory forums or the Rutgers Postal and Delivery Economics conferences has influenced the strategies, laws, schemes and innovations that delimit postal policy over the past 20 years. Cold reality limits the use of new ideas, casting some of the intellectual suggestions into history’s overflowing dustbin. Yet that changing reality also calls out for fresh insights. Tracing the dialectic between the ideas, proposals, plans, and actual developments in North American postal markets since 1990 is the purpose of this writing.

Key to understanding the recent history of the postal industry in the U.S. and Canada is an understanding of the fundamental nature of postal markets and the basic issues that have arisen as analysts contemplated the industry. Such issues have been debated at these conferences throughout the, it now seems, relatively peaceful 1990s. But they have reappeared in intriguing new forms in the years since.

Among those issues are: Is the postal industry a natural monopoly? What is the meaning of the postal universal service obligation and how can it be financed, especially under growing competition and the threat of bypass? How should components be priced to encourage competition and yet insure the financial viability of the post? What are the pros and cons of the structure and control options – private, Government Corporation, government agency? What governance structure is most likely to foster innovation? What kind of regulation? How extensive the scope of monopoly?

The period from 1990, when the conferences began, up until the reforms of the middle part of the following decade, was characterized by growth and conflict. In the United States, for example, conflicts arose between the USPS and its customers over sharing the surplus generated by the growing industry, and the federal government stepped in on several occasions to claim a piece as well. Meanwhile Canada Post struggled to become a profitable Crown Corporation with just one shareholder, the Canadian government, while maintaining important social obligations. Canada Post was given pricing freedom, with a price cap on just the basic letter rate but faced a moratorium on closing small rural post offices. At the conferences, debates arose on such questions as pricing, regulation, the scope of the reserved area, and the growing calls for reform, including plans for inducing efficient behavior by postal managers.
After ten years of discussion by the Congress, the Postal Service, mailers and competitors, a reform act was finally passed late in 2006. Issues that had been debated at these conferences were now codified and began immediately to affect the industry. Prices, previously set by the PRC with respect to forecasted costs, were frozen in real terms. The Postal Service got some pricing flexibility but constraints were placed on diversification, the cost of future liabilities were to be recovered from current customers, restrictions on access pricing were written into the law. It also was to be regulated with a greatly strengthened third-party regulator. Meanwhile Canada Post proceeded on its path toward corporatization and by 2007 had become debt-free and was poised to begin an ambitious modernization plan.

The new day had barely dawned when, in 2008, a perfect storm of bad economic news struck and the Postal Service and Canada Post and both found themselves in dramatically worsening environments. The worst recession since the 1930s, which accelerated the diversion of business-related letter mail, the pull-back in the advertising market, and other factors lead USPS and CPC down the path toward substantial losses, leading to the loss of billions of dollars in both countries by 2010. In addition, losses in its pension fund sharply increased Canada Post’s pension liabilities and the Postal Service was hit with a regulatory shift requiring it to spend billions of dollars a year prefunding its retiree health-care liabilities. Such theoretical issues as the death spiral, intermodal competition, bypass, price caps, now leapt lively across the stage of reality. Again, the interplay of ideas and reality emphasized the importance of ongoing research in postal economics.

Since 2008, USPS has mounted efforts to downsize its network, shedding delivery routes and work hours, and putting forward plans to reduce the USO by lowering the frequency of delivery and delivery standards. Price increases once again find their way to the table as the PRC, USPS and the courts struggle over whether the cap should be pierced by reason of exigency. Canada Post suffered both a strike and a lockout in 2011, with postal services suspended for nearly three weeks. It now contemplates reducing delivery frequency to three days from five days. Meanwhile, debates rage over the fundamental changes confronting postal markets in the digital age, the cost savings available from changes in the USO, how to combine competition and cooperation, and over the best strategy in the face of recession, all amidst new calls for reform of the business model. The development of innovative ideas is more important than ever.

The Postal Economy in the UK and Rutgers Conferences since 1990: A Review of Developments and Economic Themes

Frank Rodriguez, Oxera

The first Rutgers conference on Postal and Delivery Economics was held at Rugby in the UK in 1990. The conference returns to the UK in 2012 where the organizers will be holding the 20th in the series. In the intervening period much has changed in the postal economy throughout the world and particularly in Europe and North America. However, the subjects covered at the 1990 conference began to address many of the questions that would be posed by these changes and that conference and succeeding ones (and accompanying books containing some of its papers) have contributed much to the analysis and understanding of developments in the postal economy.

The enduring theme of the conferences has been the analysis of postal markets and policy and the factors affecting these in a period of major change for the sector. Within this overall theme there have been some very major sub-plots. For example, a requirement for universal postal service is set by parliaments and policy makers in all developed countries while at the same time these bodies call for efficiency and innovation which is seen as being facilitated, inter alia, by competition between postal operators thus creating the potential for lack of congruence between these objectives; and the postal market is threatened by e-substitution and dramatic changes in demand in ways that have developed significantly over the last 20 years from steady growth in mail volumes in the first part of the period to substantial overall declines in recent years. The topics addressed by the conference, whether in 1990 or 2012, have explored fundamental economic themes of this type.

The current paper would look at these themes from a UK perspective. It would outline briefly key developments and major changes in the UK postal market and policy environment since the first conference and highlight how the subject matter of the conferences and their proceedings published in the conference series of books have provided understanding of these developments and changes and so helped to illuminate and inform policy. The main economic themes explored by the conferences have been highly relevant in this regard. These have included: analysis of the demand for mail and e-substitution and of customer preferences and needs; the structure of postal networks and natural monopoly; variability in costs and efficiency of the postal value chain; the pricing of mail; universal service and accompanying obligations on service providers; competition and competitive entry to postal markets through access and bypass; economic regulation and competition law; and the future of post and public policy towards the sector. The paper would provide a review of developments and economic themes explored by the conferences and seek to highlight their contribution to the analysis, understanding and perspectives on postal sector policy in the UK.
The paper is offered as one of three which will look at these themes within various jurisdictions, the others being France/Europe and North America. One of the strong features of the conferences over the years has been their international character which has allowed them to identify similarities and contrasts between developments in different jurisdictions, for example between countries in Europe and North America. As one of three papers, it would draw out the richness of the conference proceedings and their contribution in the UK and allow comparison with the other papers covering differing institutional and market environments.
Status of the Postal Service Twenty Years After the Green Paper: A Franco-European Perspective

Joëlle Toledano (Professor of economics, Supelec)

The green paper on the development of the single market for postal services (COM (91) 476 final) was published in June 1992 11th, almost 20 years ago. The postal services in Europe were under multiple constraints (issues/ threats):
- Institutional, with almost everywhere separation from telecom activity,
- Economic, with financial deficits and often-disputable quality of service,
- Technological
- Competitive (many cases before the Commission and/or the Court of Justice of the European Union).

The green paper proposed a scenario of combining gradual opening of the market with harmonization measures to ensure the universal postal service.

Twenty years later, demand decreases significantly and the scope of universal service returns to the debate. In each country competition is restricted to niches and limited. As far as postal services are concerned, the objective of the European “single” market- that is to say that only one market exists for all Europe- doesn’t work really. The European postal market is essentially a juxtaposition of national markets .However, the majority of European operators have weathered the decline of traffic and service quality has improved significantly.

What assessment can be given for the last two decades, as regards benefits for both operators and consumers (large and small)? Have the works and economic debates (especially those of the Rutgers conferences) anticipated and / or accompanied the policies carried out? Are there significant differences between countries? Why? Did national policies aim for the same goals? (With respect to the incumbents? with respect to the regulators?)

These are the questions, which the paper will seek to answer based on developments in some countries (Sweden, Germany, Spain, etc.) including of course France.

A final section is devoted to the problems the regulators will cope with in the coming years.

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Are Letter Price Elasticities for Higher than Econometricians Think?

F. Fève*, J.P. Florens**, S. Soteri^v

Over the past decade advances in technology have, overall, negatively impacted the demand for letters in most countries with advanced postal networks. This negative impact is mainly due to two factors. First, new technology is offering consumers and businesses an increasing number of alternative media communication channels to choose from to meet their communication preferences. Second, the price of accessing and using e-related communications is declining relative to letter prices. One or both of these factors are often referred to by some postal business managers to justify their belief that postal price elasticities have increased over time. However, a number of UK time series econometric studies find that price elasticites for mail volumes in total (that is, net of switching between postal products) are low and have not tended to increase in recent years^2.

There are two main types of explanation for this finding. First, the substitution from letters to e-communications could mainly reflect increased choice in the communications market and individual preferences and price is relatively less important. Second, it is possible that the estimated letter price elasticities could be underestimated and the impact of e-substitution over estimated. This paper will examine the extent to which estimated price elasticities for transactional mail and estimates of the erosion of letter traffic demand due to technology effects may be biased in an environment where technology is evolving and the population is adapting its communication patterns over time. In particular, this paper will examine whether standard econometric estimates for own-price elasticities of transactional letter traffic are downward biased and, as a corollary, whether estimates of the impact of technology are overestimated.

In order to understand these phenomena we plan to study by simulations (Monte Carlo analysis) a model based on two main features. First of all, the model considers transactional mail demand through a sequence of time periods. At each time t there exist two categories of receivers of transactional mail called “Letters (L)” and “E people (E)”. L receivers do not use the internet and may only be contacted by regular mail while E people use the internet and may be contacted by regular mail or by electronic mail. Moreover, the model is based on the demand for mail by senders such that they match receivers’ ability to receive communications by post or electronic means. This generates three different demands (letters for L people, letters for E people, electronic mail for E people) driven by the size of the market, prices and the economic activity.

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The simulation model will assume, as in reality that the econometrician observes only a part of this system and estimates a number of standard dynamic equations. An examination of the estimated equations relative to the “true” elasticities produced by the simulation model will provide valuable new insights. In particular, the paper will help identify whether, and under what conditions, standard econometric techniques may potentially bias estimates of letter price elasticities and estimates of the downward pressure on letter demand arising from technology related factors.

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**Electronic substitution and postal price elasticities: a customer market approach***

L. Veruete-McKay\(^1\), R. Sheldon\(^2\), P. Burge\(^3\), A. Lawrence\(^2\)

Advances in technology are blurring the boundary between the delivery of communications via physical and electronic means. This is negatively impacting postal operators’ delivery volumes and due to diseconomies of scale, exerting upward pressures on average costs.

Econometric estimates of the demand for mail, in different countries, suggest that postal price elasticities are low and that rising costs might be compensated for by increasing prices. However, the majority of these studies estimate the impact of price and technology as being independent drivers of the demand for mail.

This paper draws on recently completed customer focused market research to examine whether or not postal prices and technology are independent of one another. This research will help to inform whether econometric models might be underestimating the postal price elasticity. In particular, this analysis will assess the degree to which structural factors are placing downward pressure on the UK transactional mail (and social mail) volumes and the extent to which this may be due to future price increases, based on stated intention surveys for businesses and consumers.

In addition, this type of analysis can be used to inform mail volume projections of a National Postal Operator when data based models that rely on econometric models do not incorporate future impacts of e-substitution due to their backward looking nature. Feve et al. (2011) discussed good practices for forecasting in the context of projecting demand for mail under uncertainty, and explained the importance of augmenting data based model forecasts with additional sources of information that aim to take into account the “not identified” component of forecasts. The stated intention surveys represent an empirical application of quantifying the non-identified component, which can capture the future impact of e-substitution on mail volumes. Finally, this analysis can be extended more widely in other countries with advanced postal networks.

REFERENCES

NOTES

*The analysis contained in this paper reflects the views of the authors and not necessarily those of Royal Mail Group.

1 Royal Mail Group

2 Accent

3 RAND Europe
THE CHOICE BETWEEN MAIL AND DIGITAL IN THE PROVISION OF FINANCIAL SERVICES: A DOUBLE HOTELLING APPROACH

P De Donder, H Cremer, P Dudley, F Rodriguez

Historically financial institutions have been large mail users as they provided financial information and paper statements to their customers, but in more recent times their customers have been offered the choice of alternative services through the digital medium on-line. The customers of these institutions not only have a choice of bank, but also a choice in the kind of service they receive within the transactional market. In recent years we have observed a significant switching from transactional mail to the digital alternative. These market developments are important for policy makers to understand as they seek to maintain the financial viability of the Universal Service Provider (USP).

In De Donder et al. (2012), we looked at the welfare and pricing impacts for the USP and use of transactional mail in the presence of a digital alternative and charges to customers for mail and digital services. We considered the case where a social planner sets the producer and consumer prices (other than those assumed to be constant) to maximize welfare. We also considered the case where the banks profit maximize in setting their consumer prices in the transactional market with the social planner then setting other prices for postal products to maximize welfare. Finally we introduced a cap on the single piece price, with the USP’s financial viability threatened by the digital competition to transactional mail. The results and analysis brought to the fore the consideration of public policy and the balance of choices between the consumer demand for the universal service and associated fixed costs of the USP, the incentives and profit maximizing behaviour of the banks and the consumer demand for and development of the alternative electronic medium.

In this paper, we look more closely at the customer behaviour in the transactional market and factors that influence the choice of services. In particular, we look at the choice between two financial services distinguished by paper and digital statements within a model à la Hotelling. Two horizontally differentiated banks compete to attract customers by offering, among other things, two horizontally differentiated transactional media: paper statements and a digital alternative. Customers differ according to their intrinsic preferences for one bank versus the other one (for reasons assumed to be exogenous) and for one transactional medium versus the other one. We assume that the two dimensions of preferences are independently distributed in the population. We focus on the pricing by banks of transactional media, so that we concentrate on how banks attract (or retain) customers by pricing the two transactional media in order to maximize their profit. We study how the demand for paper statements by banks' customers is affected by, among others, the degree of differentiation between banks and between transactional media, the willingness to pay by customers for transactional media, and the price of mail as set by the USP to the banks. We complement our analytical results with numerical examples to illustrate how these factors affect mail volumes, transactional media prices, welfare and profits.

This analysis informs policy makers about the movement of mail to digital that is currently so prevalent. For example, it informs policy makers of the market context of changing the value of variables that might be under their control, such as the price of mail charged to financial institutions.

References
ABSTRACT

The proposed reform of EU rules on public procurement: a postal sector’s perspective

Alessandra Fratini

The paper will discuss the substantive implications for the postal sector of the ongoing review of the EU rules on public procurement and concessions, against the background of full market opening and the increased convergence between EU public procurement and State aid rules in the compatibility assessment of USO compensations.

The legislative package for the modernization and reform of the public procurement regime (revision of Directives 2004/18/EC and 2004/17/EC) and a new Directive on concessions are expected to be presented by 2011. The reform of public procurement shall provide adjustments to the scope of the Directives (activities and types of contracts), clarification of the notion of special or exclusive rights, simplification of procedures and reduction of administrative burdens. The new Directive on concessions will introduce a specific legal framework for the award of concessions within the EU, as the current regime gives rise to serious distortions of the internal market and originating inefficiencies due to lack of legal certainty.

The paper will analyse the impact of the new measures from two perspectives. First, it will review the significance of the measures for postal operators when they are entrusted with the US. Secondly, it will assess their impact on postal operators qualifying as “contracting entities” and awarding contracts for the provisions of works, supplies or services, in the context of the revised Utilities Directive.

In the first perspective, the paper will look at US entrustment and the compensation of its costs, in light of the increased convergence between the EU public procurement and State aid rules. In fact, on the one hand Member States can use public procurement procedures as one of the recommended mechanisms for the designation of USPs. On the other, the proposed reform of the package on the Services of General Economic Interest makes it clear that the simplest way for public authorities to meet

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3 Under the current regime, in fact, the award of works concessions is subject to a limited number of secondary law provisions, while service concessions are covered only by the general principles of the Treaty on the Functioning of the European Union.
the fourth Altmark condition (and not to incur in State aid) is to conduct a tendering procedure in line with the applicable public procurement rules, insofar as the tender allows for the selection of the tenderer capable of providing those services at the least cost to the community.

In the second perspective, the paper will address whether and how the new rules affect the qualification of USPs as contracting entities, with reference to the removal of exclusive rights.

In conclusion, taking into account the draft texts in their progressive stage of development throughout the legislative process, the paper will illustrate the risks and challenges of the new legal framework, in particular for USPs and operators qualifying as contracting entities.

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“The new SGEI Framework and its implications for the postal industry

By: Damien Geradin

On 15 September 2011, the European Commission released a draft “EU framework for State aid in the form of public service compensation” in which the Commission details the way it intends to apply State aid law to State compensation for the provision of services of general economic interest (SGEIs). Following a period of consultation, the final version of this Framework will be published in January 2012.

This Framework will be of fundamental importance to the postal sector. In all Member States of the European Union, postal operators carry a number of SGEIs going beyond the scope of universal service. Postal operators may, for instance, be asked by the State to maintain post offices in all municipalities, to distribute newspapers every morning at a low price, to pay State pensions at the domicile of the elderly, and offer an array of other services that postal operators would not normally offer due to their lack of profitability. These SGEIs are generally provided against a compensation offered by the State. While this compensation is justified given the costs incurred in the provision of SGEIs, over-compensation will trigger the application of State aid rules. A number of Commission investigations regarding alleged over-compensation to postal operators are currently pending.

In this paper, we intend to look at a number of complex and critically-important issues raised by this new SGEI Framework, including:

- the importance for the SGEIs to be defined in an act of entrustment and the acceptable length of the entrustment
- the interplay between public procurement rules and State aid rules (is tendering of SGEIs necessary?)
- the principles and methodologies to be applied to determine the acceptable level of compensation, including cost methodologies
- the determination of a “reasonable profit”
- the additional requirements “which can be necessary to ensure that the development of trade is not affected to an extent contrary to the interests of the Union”

All these issues will be illustrated with practical examples specific to the postal industry.”
Denis Sparas

(1) Working title

Revision of EU State Aid rules in relation to SGEIs – what, if any, implications for the postal sector?

(2) Abstract

One of the main objectives of EU postal reform was to safeguard the provision of universal postal services. In this vein it is important that such services, and for that matter all services of general economic interest (SGEIs), operate and are provided on the basis of principles and requirements that enable them to fulfill their public service mission.

Within this context one of the issues often arising is the question of the need to finance the entrusted undertaking for providing these services under economically acceptable conditions. In order to do that it is important that any financing mechanism that is applied follows sound legal principles, which are known and identified in advance and assessed on case-by-case basis by the competent authorities.

Two sets of rules are of relevance for the postal sector and possible financing of unfair financial burden of providing universal postal services: (i) sector specific legislation enshrined in Postal Services Directive and (ii) EU State Aid rules enshrined in TFEU and so called "Monti/Kroes" Package.

(3) Objectives of the paper

In view of these two sets of rules applicable to a possible financing of unfair financial burden for the designated universal service provider(s) the objectives of the paper are:
to shortly present applicable regulatory frameworks in relation to the financing of USO, with specific focus on the revised SGEI Package;

to analyze main elements, notably new solutions, of the revised SGEI Package in view of the possible impact and interplay with relevant solutions envisaged by the Postal Services Directive.

Particularly, the paper will in this context analyses (i) the main conditions from the view point of the SGEI Framework for declaring public service compensation compatible with the EU State Aid rules (e.g. concept of genuine SGEI; efficiency incentive) and (ii) the interplay of these with sector-specific instruments (e.g. concept of unfair financial burden; availability of remedies).

The main subject of the research is to analyze a very pertinent area for the future application of the EU postal regulatory framework in view of the revision of SGEI Package while having in mind the need to safeguard the provision of universal postal services under economically acceptable conditions.

While the subject matter of the paper may not be a novelty as such, one needs to have in mind that the revised SGEI Package introduces certain new notions and solutions, which will have implications also for the future revision of public service compensation measures in the postal sector (e.g. reasonable profit; availability of remedies; efficiency incentives).

The paper will be primarily policy oriented, with a focus on legal analysis of the applicable legislation, as well as an economic analysis perspective on the possible effects of different types of measures employed ("the least distortive financing" concept).
While the question of the application of State Aid rules in the postal sector has been addressed by various authors in recent years (e.g. Frattini; Kirschall), this paper intends to provide insight and assessment of new and revised SGEI Package with also taking into account latest decisions of the competent EU institutions (e.g. Commission; CJEU) in as much as available and relevant for the present paper.
Defining an intermodal USO for communication

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Abstract
This paper discusses the potential for an intermodal definition of universal service obligations in post and telecommunications. It also presents a stylized model to assess the social costs and benefits associated with various USO scenarios.

Declining letter mail volumes will continue to challenge postal operators in the years to come. As a consequence, the scope and definition of the postal universal service obligation (USO) is increasingly debated among politicians, practitioners and academics. Analogous considerations are taking place on the telecommunications side, where it is discussed whether the traditional voice-based USO should be complemented or substituted by a broadband USO for broadband services. For example, the European Union amended the universal services directive 2002/22/EG in 2009 to complement the USO with broadband access, however without prescribing a specific bandwidth (2009/136/EG). A year later, the EC expressed in its “Digital Agenda for Europe” the objective that all Europeans should have access to internet of above 30 Megabits per second (Mbps) by 2020.

These parallel, but not integrated discussions on reducing the postal USO on the one hand and extending the telecommunications USO on the other can be explained by the partial convergence of the two industries. Written communications, once the exclusive domain of postal operators, is increasingly relying on digital media that are transmitted over telecommunication infrastructures. As a consequence of this convergence, the telecommunication infrastructure has become an essential infrastructure for written communication, while physical letter mail is increasingly substituted.

From a regulatory perspective the question arises whether and if so, how this convergence should reflect itself in the definition of the USO on the postal and/or telecommunications side.

Maegli et al. (2010) have proposed a “unified approach” to regulate universal services in posts and telecommunications. Such an approach would consist of a jointly defined universal service obligation and corresponding regulation, together with a separated, sector-specific regulatory regime for monopolistic bottleneck resources and interconnection issues. This framework would be consistent with the layer-oriented framework often applied in the telecommunications market (“disaggregate approach”, see Knieps, 2002). Jaag and Trinkner (2011) have elaborated the issue further. With respect to the postal USO, they propose a future-oriented definition of the USO which follows the economic
two-sidedness of the postal market and five generic principles: output-orientation, technological neutrality, product neutrality, necessity, and viability.

In this paper, we extend the framework proposed in Jaag and Trinkner (2011) to assess the potential of a truly combined “USO in communications”, i.e. a USO that simultaneously defines the physical and digital requirements for the conveyance of communication irrespective of the specific sector. We base our recommendation on a generic theoretical model of the social cost of USO which trades off potential savings in daily physical delivery against the one-off cost of developing broadband access networks.

References


Electronic substitution and USO scope definition

Gennaro Scarfiglieri, Marcello Cuomo, Tommaso Nardone and Alberto Rovero

The long term trend of decreasing mail volumes – which is likely to be exasperated over the coming years by a prolonged situation of economic crisis – is causing a continuous uptrend in the unit cost of mail, which cannot be fully reflected by service providers in the development of mail prices, as higher prices accelerate substitution of physical with electronic messaging. Under the condition that the firm providing the service is free to adapt its service level and its base cost to worsening conditions, it is still possible to work out ways to render the firm financially viable. However, the requirement to provide a universal service (national geographic coverage, five days a week service, j+1 service) imposes a number of rigidities on the cost structure of the universal service provider that seriously threaten its financial viability. A universal service provider may well find itself with a widening gap between its unit cost and unit revenue that cannot be reduced, unless universal service requirements are changed.

The topic of a reduction of the scope of universal service provision has been examined by several authors in the literature. Leskinen et al. (2009) have questioned the need for a broad postal universal service definition, arguing that the scope of the universal service should be narrowed to an extent sufficient to ensure that messages are conveyed. Some authors (Felisberto et al. (2006), Friedli et al. (2006)) have examined the possibility of mass customization in the delivery services, where the receiver chooses to pay a fee in order to obtain a service level which properly reflects its preferences. Carslake et al. (2011) and Pearsall and Trozzo (2011) have examined the demand effects of universal service scope reductions. Cohen and McBride (2008) and Borsenberger et al. (2010) have estimated cost saving deriving from the reduction in the delivery frequency.

Following the work of Bradley et al (2009), in this paper we explore the issue of universal service requirements reduction in the face of worsening market conditions. More specifically, in a first step we
estimate the weight imposed on the cost structure of a universal service provider by each of the elements of the USO scope; we then build a model where a narrowing of each of the elements of the USO scope is evaluated in order to financially counterbalance a worsening of market conditions. The end result of the simulation is a grid which associates an optimal mix of USO scope reduction in respect to any given decline in mail volume.
The mail delivery office activities form a major part of the costs in the provision of the universal service. There are many of them to service localised deliveries to mail recipients, each performing similar functions. They are also highly labour intensive. Operators need to understand the cost function and dynamic efficiency opportunities for delivery offices to inform its business decisions, and the need to do so is intensified by on-going declines in mail volumes.

Parametric techniques were applied to a single year of cross section data of nearly 1400 delivery offices in the UK (Horncastle et al 2006, Moriarty et al 2006), distinguishing noise and inefficiency and estimating the cost function of the efficiency frontier. Non parametric techniques were developed and applied to the cross sectional data (Cazals et al 2008). Parametric techniques were then extended to multiple years of panel data (Cazals et al 2011 and 2012), to take account of potentially missing variables in the cost function (in the form of unobserved heterogeneity) and showed that cross sectional, stochastic frontier analysis (SFA) estimation formed good estimates but could be improved upon by particular forms of panel SFA.

These all looked at the mean efficiency estimate of total costs at the delivery office, with an estimation of the cost function for the efficient frontier. However, these techniques may also inform the individual efficiency levels from the estimated efficient frontier. Given the presence of noise within the data and unobserved heterogeneity, there is a question as to the reliability of individual or grouped efficiency estimates from the estimation techniques. This is particularly relevant for management and regulators looking to establish the level and location of the potential improvements.

In this paper, we will look at the reliability and bias in the estimation of individual efficiencies when applying different parametric and non-parametric techniques. Using data simulations and the range of techniques looked at in Cazals et al 2011 we will look at the variation in estimating the true efficiency. We will also extend this analysis to include a similar assessment of non-parametric techniques, where some developments in the research literature in recent years have specifically looked at reducing the degree of bias in the estimation.

When the postal operators are facing rising unit costs in the presence of fixed cost as mail volumes are moving to digital competition, there is even greater need to understand costs and opportunities for dynamic efficiency improvements. This paper will look to shed light on the potential for efficiency techniques to extract valuable insights from postal cost and operational data.

References


Abstract: *Efficiency analysis of the main postal operators: a comparison between United States and Europe*

By: Maria Rita Pierleoni and Stefano Gori

In this paper we will apply efficiency analysis methodologies to a panel consisting of La Poste, Deutsche Post, Royal Mail and Poste Italiane and USPS.

A brief literature will be presented on the methodologies utilised to study efficiency in regulated network industries; these methodologies are distinguished in parametric and non-parametric techniques. For the postal sector there are few empirical studies on efficiency that are based on these methods. This paper attempts to analyses efficiency based on a general approach proposed by some seminal theoretical and empirical publications on this argument, such as Farrell (1957), Schmidt, Lovell and Fried (2008) and Filippini et al (1993). The efficiency analysis will be based on the following main parametric and non-parametric techniques: Ordinary Least Square Fixed Effect, Random Effect, Maximum Likelihood (Stochastic Frontier Analysis) and DEA.

The main objectives of the paper are: a) to investigate the results obtained by the different postal operators; b) to underline the differences in the results, in term of ranks obtained, by applying the different methods to the total cost function and the unit cost function; c) to verify the impact of the exogenous variables over the level of efficiency, in terms of ranks, obtained for the two cost functions.

More specifically, the analysis will be carried in different steps:

1) estimation the empirical relations between the - total and unit - cost functions for the operators selected and the main explanatory and independent variables, including exogenous variables;

2) application of the methods for the efficiency analysis to the total and unit cost functions with and without the exogenous variables;

3) presenting the estimation obtained;

4) ranking the different operators according to each method applied;

5) applying the specification tests for choosing the “best” method and the related rank;

6) discussing the results obtained and comparing these with and without the exogenous variable

7) policy implications.
References


Price comparisons in the parcel industry: a new approach based on the hedonic price theory

Claire Borsenberger, Sébastien Bréville and Aurélie Dehais

Whereas e-commerce activity is expanding, the parcel sector is more and more under scrutiny. In 2011, the European Commission studied in particular the EU cross-border parcels market and plans to write a Green Paper on the price of cross-border parcels in 2012.

Opened to competition for many years, a part of the parcel sector is subject to universal service obligations, notably to an affordability constraint. These obligations concern over-the-counter parcels, from private households. In view of the growth of parcels among private households, the affordability issue of parcels could become more and more essential in the future.

Until now, this issue has been dealt essentially through international basic price comparisons based on absolute values, adjusted to take into account differences into purchase power between countries. However, as emphasized by Campbell et al. (2004) in a WIK report for the European Commission, “for parcel services, price comparisons are significantly more complex because there is much more variation between parcel products offered by European USPs. (...) These differences in service have a significant effect on the cost of parcel delivery that may explain some of the variation in parcel tariffs.” Despite these caveats, in all subsequent European studies, parcel prices continued to be compared in absolute terms and some national and European regulations are based on these comparisons.

To improve international benchmarking, we propose in this paper to look at USPs’ domestic parcel prices as a hedonic function and to develop a hedonic price index for domestic parcels. In this approach, a good is considered as a vector of characteristics. Therefore, a hedonic equation relates the price of the good to the implicit price of its characteristics. This method has been used for the valuation of public goods and environmental good but also applied in market research for private goods like houses, cars and food products. Fenster et al. (2006) and Pearsall and Trozzo (2011) applied it to postal services.

Before analyzing the estimation of each relevant characteristic’s implicit price given by the hedonic equation in the last section of our paper, we describe, in the first section, the domestic parcel market for a range of European countries and, in a second section, we briefly present our model based on the hedonic price theory. Section three provides summary and conclusions.

References


THE IMPACT OF E-COMMERCE AND ICT ON PARCEL OPERATORS’ ACTIVITY

Claire Borsenberger, Emmanuelle Ligouzat, Marine Oddo and Philippe Régnard

Whereas the impact of e-substitution on letter mail volumes has been intensively studied (see for instance Cazals et al. (2011), Meschi et al. (2011), Nikali (2011)), the impact of the development of information and communication technologies (ICT) on the parcel activity of postal operators has been less investigated.

More generally, the parcel sector has been less studied than mail sector by postal experts, with however notable exceptions. For example, De Donder et al (2002) and Crew and Kleindorfer (2004) examined access policies and optimal prices for parcels. Dietl et al. (2009) analyzed market entry and competitive strategies in the German business-to-business (B2B) parcels sector. Last year, at the Rutgers conference, Longman et al. examined the features of competition on packets and parcels markets and its regulatory implications for postal incumbents and Gibson and Race (2012) made a study on UK Packets and Parcels Services Market.

Regarding the impact of ICT on parcel activity, everyone agrees BtoC e-commerce is sustaining parcel activity and is a great opportunity for postal operators. E-commerce facilitates transactions in tangible goods which, contrary to traditional retailing, must be transported and delivered at the right place for the consumers. So, activity of parcel operators seems to be positively correlated with the development of e-commerce but, at our knowledge, this has not yet been demonstrated formally.

The objective of this paper is to better understand the drivers of parcel volume and the impact of ICT on the volume. At a first sight, the most obvious drivers of parcel activity seems to be the country’s income (GDP), demographic factors (number of inhabitants in urban and rural areas, the age structure of the population and so on), retailing characteristics (commercial density, number and localization of retailers, accessibility to retailing facilities) and for few years, broadband access and ICT equipment of households and the quality of delivery service offered.

In the two first parts of our paper, we will study the dynamics of the distance selling activity and the development of e-commerce on one hand, the activity of parcel sector on the other hand, in France and in a selection of other countries, notably the UK, Italy and Finland. In the third section, based on this review, we will confirm or infirm our intuition on the main drivers of parcel activity. Based on an econometric
regression, it could also be possible to predict the evolution of parcel operators’ activity in a near future, according to forecasts made by experts on e-commerce activity, demographics statistics, GDP and public policy regarding Internet access.

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“Are Exogenous Influences Or Internal Strategic Measures Crucial For Postal Success?”

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The world of postal organizations has become more complicated in the last few years. While posts were preparing for competitors and the attempt to have influence on the regulatory organization of market opening, the real pressure came from the demand side. Most postal incumbents suffered from significant shrinking mail-volumes. The economic crisis in 2009, which is back in enhanced form in 2012, accelerated this development.

As a network industry the postal organizations are mostly not able to reduce costs to the same extend as the revenues are decreasing. The results are partially significant cutbacks of profit. Malicious gossip has it that the giant USPS could crash soon. According to the UPU-statistics most of the European Posts had a CAGR of more then -5% in the Operating Results. Even though the situation is not good throughout there are major differences between the postal organizations. These differences become more conspicuous in the Net Results.

To improve the understanding of which possibilities could help secure the profits it is essential to understand which elements lead to the differences between countries. There are two groups of possible influences: exogenous influences and internal strategic measures. Possible factors which are not influenceable by a postal organization are e.g. the regulatory regime, economic development in the markets, relevant competitors in the market, market size, average household size and so forth. On the other hand some significant different business alignments are observable like the importance of financial services, the extent of involvement in electronic communication, the role in the parcel and express market, and some others. Beside these external factors observable from outside some less well-known strategic decisions have influence on the profit as well.

The main goal of this paper is to glean as many facts about the potential influence factors as possible and to verify their effects on the profit situation. To collect more input data, besides the analysis of official statistics and annual reports a survey with a sample of market experts in different countries will be conducted. To prove the relevance of the factors the use of a Partial Least Squares Model (PLS) is the main objective in this paper. In addition to the mathematical interpretation of the model the analysis of the contents will give a clear view on the possible binding screws to improve the profit situation of a postal organization.

References:


The Upside to Downsizing: Measuring the Environmental Benefit of Right-Sizing the U.S. Postal Service’s Operations

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The United States Postal Service (USPS) has seen mail volumes collapse in recent years, and current forecasts show the erosion of mail volumes is expected to continue into the future. As a result, the Postal Service embarked on unprecedented cost-cutting measures to stop the bleeding and return the USPS to a profitable financial position. Further cost savings measures are planned to eliminate $20B in costs by PFY2015 including Legislative, Operational, and Compensatory changes to again return the USPS to a positive net income position during PFY2013. To date, much of the public discourse has centered on the financial benefit of ‘right-sizing’ the USPS’s operations.

While clear financial benefits exist from consolidating processing operations, little attention has yet been paid to the environmental benefits realized from downsizing USPS operations to their ‘right size’. The purpose of this paper is to quantify the environmental benefits associated with downsizing USPS operations from their current state to the levels being proposed by USPS and its key stakeholders.

Our paper will:

1. Present an overall methodology and a set of metrics for quantifying environmental benefits for large-scale network changes within the postal context, leveraging existing methodologies from both postal and non-postal sources

2. Evaluate the environmental benefit of reducing the current complement of USPS processing centers (roughly 500) to the number currently proposed by the USPS in their plans submitted to Congress

3. Evaluate the environmental benefit of reducing the current complement of USPS Retail locations (roughly 36,000) to the number currently proposed by the USPS OIG report “A Framework for Optimizing and Modernizing the U.S. Postal Service Retail Network” (presented at the 2011 CRRI Rutgers Conference by Mohammad Adra and Renee Sheehy)

4. Evaluate the environmental benefit associated with optimizing and reducing the amount of transportation needed to support reduced mail volumes in a network with fewer processing centers and fewer Retail locations, including a discussion of the tradeoffs between the potential for increased air transportation necessitated by greater distances between facilities and more facilities served by ground transportation

5. Evaluate the environmental benefit of moving from 6-day to 5-day delivery
These results should be of interest to policy makers and postal stakeholders as they debate alternative legislative proposals to ‘right size’ the USPS network, providing an additional lens with which to view the impacts of allowing the Postal Service to reform its operations and synchronize its physical processing and delivery footprint to a reduced national mail volume. These results will also be of interest to postal administrations seeking methodologies to understand the environmental impacts of changing their networks in response to changes in demand.
Letter traffic demand in the UK: Some new evidence and review of econometric analysis over the past decade

John Nankervis, Marzena Jarosik, Jonathan Pope, Soterios Soteri and Leticia Veruete McKay

The period since 2008 has been a testing time for national postal operators in advanced industrialised countries. Downward pressure from increasing levels of technology related substitution and the steepest recession in over seventy years are negatively impacting postal operators’ traditional income streams from letter traffic and, due to diseconomies of scale, exerting upward pressure on delivery costs. In response to these factors, as well as a number of others, the price of letter mail in the UK has increased substantially.

The severity of the economic downturn in the UK followed at a later date by large price increases provide valuable information with which to assess the factors affecting the demand for mail. The aims of this paper are three-fold. First, the paper aims to identify and quantify the key drivers of the demand for mail in the UK using time series econometric techniques with information up to 2011 Q1. This will extend the analysis undertaken by Veruete-McKay et al (2011) by an additional, and highly eventful, 12 quarters. During this period, inter alia, the UK entered a severe recession from which it had only partially recovered by the end of the sample period; technological change affecting the mail market continued at a rapid pace; and prices for at least some mail products rose substantially.

The second aim of the paper is to compare the findings of the analysis using the extended data set with previous econometric research into the demand for mail in the UK over the past two decades. Analysis of this extended data set using econometric techniques and its comparison with estimates from previous work therefore contributes new evidence to aid understanding of some major issues regarding the demand for mail. These include whether the link between economic growth and mail volumes has changed significantly in the recent past or even, as some have claimed, been “broken”; whether price elasticities have risen appreciably as a result of changes in the market environment; and the possible extent of the impact of e-substitution on mail volumes and how this may have developed over time.

Third, we bring together the results of our analysis in earlier parts of the paper to provide estimates of the contribution of different factors to the decline in UK letter demand in recent years. A final section of the paper concludes and highlights some key areas in understanding the prospects for mail volumes in coming years. Although the analysis in the paper uses evidence from the UK its insights should be of value in assessing the demand for mail in other countries.

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Dynamic Letter Volume Models: How Does an Economic Downturn Affect Substitution Propensities?

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Abstract

The recent decline in letter volumes experienced by postal authorities worldwide has occurred in an environment characterized by economic instability. In times of such uncertainty mailers are increasingly likely to take action towards rationalizing their cost base and actively investigating alternative forms of communication to a traditional mail item. For similar reasons economic downturns can also precipitate further reductions in letter volumes as non-substitutive activities such as mail consolidations and billing frequency rationalizations are additionally likely to gain momentum. On the other hand, because improving the possibilities for using electronic channels instead of letters happens at different speeds in different sender and receiver segments, it leads to different substitution rates but also different letter price elasticities in different segments (Nikali, 2008).

Recent research has suggested that dynamic econometric techniques represent an effective basis for the development of segmented letter volume forecasts (Martin et al, 2010). This paper continues to employ this methodology by deriving forecasting models based on a set of vector error correction models, combined with the identification of co-integrating equations and impulse response analysis. The empirical results identify important linkages between the rates of

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\textsuperscript{8} Diversified Specifics.
economic growth and various forms of mail reducing activities whilst also providing quantitative insights into the effects of future economic crisis on letter volumes by using Finland as a case study. In particular, we attempt to identify whether an economic downturn results in a one-off downward shift in the level of demand or acts as a catalyst for further substitution resulting in an accelerated downward trends in mail over time.

Estimates of U.S. Postal Demand Elasticities Derived from a Random-Coefficient Discrete Choice Normal Model

Authors: Margaret M. Cigno, Elena S. Patel and Edward S. Pearsall

Reliable estimates of structural demand parameters, particularly price and cross-price elasticities, are essential for forecasting mail volumes and for most practical applications of economic theory to issues of postal regulation. However, conventional econometric approaches have generally failed to produce useable estimates of postal cross-price elasticities for reasons that are all-too-familiar to researchers. Postal price indices contain observation errors and tend to be highly correlated over time; the equations commonly used to model demand are overly-restrictive with respect to prices; and, the number of possible cross-elasticities becomes large relative to sample size for models that differentiate between more than a very small number of services.

Random-coefficient discrete choice logit models were designed to provide a practical solution to all of these difficulties. The past decade of empirical demand research in the industrial organization literature has been dominated by the estimation of such models following the methods of Berry, Levinsohn and Pakes (BLP)\(^9\). Following BLP, these models can be fit with only market-level price and quantity data in combination with observable product characteristics, population-level demographics and an effective set of instrumental variables. The BLP estimation methodology applies the Generalized Method of Moments to obtain a consistent estimate of the asymptotic normal distribution of the logit model’s parameters. Price elasticities and cross-price elasticities can be derived from the parameter estimates and subjected to several large sample tests for significance and consistency.

Although these models and methods are now routinely employed to obtain realistic demand elasticities and cross-price elasticities for closely-related products in many industries, to our knowledge this approach has never been attempted in the postal sector. In this paper, we apply a variant of the BLP estimation methodology using U.S. postal time series for volumes, revenues, weights, other observable characteristics of the mail, demographic information and a set of instruments to obtain estimates of price elasticities, cross-price elasticities and other parameters of the demand functions for related postal services.

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Postal operators worldwide are working on their cost structures as volumes are under threat by electronic substitution. In Europe, liberalisation and competitive entry includes a risk of additional volumes losses. While not all cost programmes necessarily have an adverse effect on service quality, some postal regulators are concerned about cut-backs in quality.

In Europe, the primary method to regulate postal quality is to set targets, monitor performance and, perhaps, impose penalties on operators that fail to deliver on their targets. For international mail, common quality requirements are set by the Postal Directive, and domestic quality standards must be set and monitored in all EU countries.

More recently, regulators in some EU Member States, such as the UK and Portugal, have created additional quality incentives by adding explicit “quality factors” into price cap formulas. In these systems for price regulation, regulated firms are allowed to increase price if they improve quality, or have to reduce prices if their quality goes down. Thereby, price regulation may reflect the link between quality of service and costs more appropriately than traditional cost-based price regulation. Indeed, the REIMS terminal dues systems, a price system established by some postal operators for charging each other for delivery of international mail, links prices to quality (transit time) as well.

The paper raises the question whether or not, and how, quality incentives should be included in price regulation. For this purpose, it describes and evaluates experiences of European regulators with quality factors in price regulation. For each country, it will discuss the objectives of quality factors, the indicators used, and the specific mechanism. This information is based on a qualitative survey among postal regulators carried out in spring 2011. Finally, the paper will present some market outcomes in order to discuss the effectiveness of the quality factor and whether the regulatory objectives have been achieved, and draw conclusions.

The paper will expand the results of a German study on quality factors in postal price regulation carried out by WIK in 2011 (Dieke/Junk/Zauner 2011) and discuss implications for other countries. In doing so, it will take note of existing literature on the topic (see references). While much of this literature studies quality regulation, and quality factors in price regulation from an analytical perspective, our paper aims at surveying practical implementation of quality factors in price-cap-formulas, and drawing conclusions from this experience.

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Regulating at a time of uncertainty

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Ofcom

In the UK, as in other countries, postal services have been undergoing a period of immense change. Mail volumes have been declining as users have moved towards e-substitutes. The overall nature of demand for mail has yet to become clear: in particular, whereas historically demand has been price inelastic, the extent to which this will remain so in the future is not clear. At the same time, and partly as a result of this, Royal Mail has found itself in a difficult financial position, bringing with it near-term threats to the continued provision of the universal service in the UK. While in conventional circumstances, the obvious regulatory approach to a company with Royal Mail’s market position would be to impose a price control, in the current circumstances this does not appear to be the most suitable approach. Instead, the balance of regulatory risks, implies that removing price controls coupled with a range of safeguards aimed at monitoring Royal Mail’s performance, safeguarding access to a basic level of USO, and ensuring continued competition provides a preferable approach.
Introduction

The past twenty years have seen fundamental change in the UK postal services market. In 1990, Royal Mail delivered 58m letters each day and returned a profit of £30m on a total letters’ turnover of £3.6bn. In 2010, Royal Mail delivered 71m items per day but reported a loss of £333m on a turnover of £6.6bn. In 1990, Royal Mail was recognizably a leader in the postal world and hosted the very first Rutgers conference on postal and delivery economics, opened by its former Chairman Sir Ron Dearing. By the 2000s, Royal Mail was described by its then Chairman as “a basket case”\textsuperscript{10}.

Focus and Scope

The paper will seek to understand the major developments in UK letter mail services and identify the extent to which the changing fortunes of Royal Mail are explained by market, organizational, regulatory or other factors. The focus will be on the strategy, conduct and performance of the universal service provider, Royal Mail, under the CEO leadership of Bill Cockburn, John Roberts and Adam Crozier in the context of the changing policy environment under which it operated. The paper will address, though not be limited to:

**Mail Volumes and Market Developments:** How has UK delivered postal volumes changed over the past twenty years? What do we know about the drivers behind these changes and how have the changing profile of mail volumes shaped the challenges facing Royal Mail.

**Governance, Strategy and Organization:** what strategies have Royal Mail pursued over the period of study and how successful have these been in responding to the market challenge. In particular, how has the universal service provider adapted their organization, networks, strategies and pricing to sustainably deliver services to business and citizens.

**Regulation and Competition:** Royal Mail has been regulated for the full twenty year period. First, by the Department of Trade of Industry through a set of financial targets (ROCE, Negative External Finance Limits and Real Unit Cost Reduction) and, for the last ten years by the independent postal regulator, Postcomm. The nature of the competitive challenge, too, has changed over the past 20 years. The paper will seek to understand how market contestability has shaped the performance of the USP.

**Employment and Productivity:** In 1990 Royal Mail letters business employed 171,000. By 1990 this had fallen to 155,000. How did labour, pay and industrial relations issues shape the

performance of Royal Mail during this period and what success has Royal Mail had in adapting its workforce to the emerging needs of the market.

**Methodology**

The paper will survey relevant past Rutgers papers on the UK market and will draw on data in the public domain, at the Royal Mail Archive and the Sound Archive of the British Library, including contemporaneous interviews with senior managers during the period under review.

**Conclusion**

There are few studies on the economic and business performance of Royal Mail for the period 1990-2010.\(^{11}\)

The paper will conclude with an assessment of the past and a prognosis for the future. It is hoped that the paper will be of interest to whom, Sir Ron Dearing, described as “the practical thinkers and the thinking practitioners”\(^{12}\) in his contribution to the first Rutgers postal conference held at Rugby in 1990.

*Dr Tim Walsh,*  
**VP Corporate Affairs, Pitney Bowes**  
*(former Royal Mail manager, 1990-2003)*  
*16\(^{th}\) November 2011*

\(^{2}\) See Duncan Campbell-Smith’s historical survey of the past five hundred years of Royal Mail, *Masters of the Post,* Allen Lane, 2011.  
Eds Crew, M. and Kleindorfer, P.
Abstract for the 20th Conference on Postal and Delivery Economics

“Assessment and Implications of economies of scale and economies of scope within Postal Delivery”
L. Janin, F. Lê, R. Sahly (ARCEP), O. Salesse (TERA Consultants)

The Postal Regulation was set up mainly due to the economies of scale and economies of scope in the postal process, particularly in Delivery. It is often argued by incumbent operators that the fixed costs are very high, which raises an issue of efficient cost allocation between products. Depending on the country, there exists a great disparity of delivery costs between geographical areas (rural areas, urban areas with high horizontal and/or vertical density of population). This disparity has risen, from the beginning of Postal Regulation, the issue of market entry for competitors. More recently, some postal operators have highlighted different approaches to optimizing the Delivery route and dealing with the problem of fixed costs: joint provision/separation between ranges of products (parcels, First class mail, bulk mail, unaddressed mail, etc.). The approaches differ among countries (e.g. Finland, The Netherlands). Developing a deep understanding of Postal Delivery Economics is therefore crucial for both operators and regulators.

A bottom-up techno-economic model has been developed by ARCEP and TERA Consultants to provide a full assessment of Delivery costs in France. The approach and modeling of Delivery costs built by Roy in 1999 and the following studies (see References) served as the starting point to the ARCEP’s model. Essentially, it incorporates a detailed geographical description of territory, including: housing and enterprise categories (standalone individual houses, individual houses in urban areas, apartment buildings, industrial areas), postal item categories (letters, flats, packets/parcels, registered, etc.) and the consideration of density levels (distance between addresses i.e. linear density, and concentration of mailboxes at each address i.e. grouping index) for each geographical area in France. The model provides results that are consistent with those of Roy’s model, with additional level of details: the examination of linear densities and grouping index in detail (88,537 geographical units are taken into account) is crucial for the Delivery costs calculation.

The model provides results that can be used to analyze of the Delivery cost function. There are indeed economies of scale between certain volumes of traffic, economies of scope among forms of products (small flat items, large flat items, bulky items, etc.). Thus, the model enables the examination of economies of scope between mail and parcel Delivery and/or addressed/unaddressed Delivery, First Class mail/other mails Delivery, etc. It is then possible to assess the threshold of benefits from joint provision/separation of products ranges.

In Conclusion, the paper underlines the current industrial restructuring of some postal operators (joint provision of certain products Delivery) in light of the results provided by this new model. Those results should be of interest for both operators and regulators and more generally all stakeholders who are looking for an economic model to apply in the context of a mail volume decrease.
Optimization of the United States Postal Retail Network by Applying GIS and Econometric Tools

JP Klingenberg, Lyudmila Bzhilyanskaya, and Michael Ravnitzky

United States Postal Regulatory Commission

Recently the United States Postal Service (Postal Service) has discussed its intention to reduce the number of Postal Service operated retail outlets by 50 percent over the next 5 years. As part of its long term strategy, the Postal Service envisions that 60 percent of retail revenue by 2020 will be generated through “alternate retail access channels;” i.e. facilities not owned or operated by the Postal Service. The U.S. Postal Service currently operates a larger fraction of its retail access points than many other national postal operators, such as Australia Post, Itella (Finland), Deutche Post (Germany), Posten AB (Sweden), and La Poste (France). These countries maintain universal geographic access while allowing the national posts to operate fewer than 20 percent of the postal retail facilities.

The governments of these countries have established statutory proximity constraints to ensure that the post maintains a national presence sufficient to provide universal access. These constraints allow posts to sub-contract a large portion of the retail component of postal services and thus minimize costs while providing broad geographic coverage. A rough analysis of the U.S. postal retail network shows that 80.1 percent of the U.S. population resides within 4.83 km (3 mi.) of a Post Office and 6.2 percent of the population resides farther than 8.05 km (5 mi.) from a post office.

Potential retail networks can be evaluated for geographic proximity of access and predicted cost/revenue by using the following information: population and employment data; postal retail facility operating cost, revenue and location data. This paper applies Geographic Information System (GIS) and econometric modeling tools to analyze the following:

1) The coverage, operational expense and revenue of both the current U.S. postal retail network as well as a network after the reduction of 15,000 locations;

2) The operational expense/revenue of a U.S. retail network that would comply with the geographic proximity requirements of international posts and correspond to the socio-economic characteristics of the market areas served by each retail facility in the network.

This paper will develop and discuss retail location solutions optimized for:

1) Access Approach, a solution which will minimize the average distance to postal retail facilities for different population density strata, using GIS modeling tools.

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13 Any Opinions are exclusively the authors, and do not reflect the opinions or positions of the Postal Regulatory Commission.

14 http://www.gao.gov/products/GAO-12-100

15 http://www.gao.gov/assets/520/511482.pdf at 19

2) Net Revenue Approach, a solution which will maximize revenue in comparison with costs for postal retail facilities, using econometric modeling tools.

3) Hybrid Approach, a solution which will maximize net revenue with respect to market areas with access constraints (i.e., statutory constraints for other national posts).

Although the paper will use data specific to the United States, the techniques developed are applicable to other postal networks as well.

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ABSTRACT

As technology evolves, demand for universal services changes and so does the cost of providing them. This paper examines the need for adapting the postal USO to the digital age and the consequences of not doing so. It relates to earlier publications by, amongst others, Boldron et al. (2006), Crew and Kleindorfer (2011), and Nikali et al. (2011), analyzing the cost of the USO and the impact of reducing the USO scope. Our paper contributes to the earlier findings in three ways.

First, it deals specifically with bank services within the postal USO. This has not been the focus of earlier research. Second, it shows that policymakers can use alternative (non-USO) instruments to solve the problems for vulnerable users. Until now, there has not been much discussion on alternative instruments targeting these users. Third, while most existing literature provide ex ante assessments of expected effects, our paper also offers an ex post analysis of experiences from reduced USO and public tendering of universal services.

The paper is based on case studies in Sweden and Norway. We investigate the situation in Sweden where basic payment services have been provided both through the postal network and through public procurement, and where the NRA recently has suggested new initiatives to guarantee future access to the services. We analyze how demand, and the cost for providing payment services, has developed over time.

We find the publicly procured solution to be a large financial improvement on the earlier USO solution. However, due to low demand, the cost per transaction was over €100 and the yearly cost per user was €1,750 in 2009. This has encouraged the NRA to suggest new solutions, such as market stimuli (dialogues with banks and continuous follow up on their accessibility), projects for technological development, and regional support, to ensure future access to payment services. We also investigate the need for including bank services in the USO in Norway and estimate the savings from alternative solutions. The need for a bank obligation is estimated based on individuals’ access to i) transactions at alternative service points or ii) alternative products, e.g. internet banking or giro payments.

We find the need for a bank obligation to be small (at most 15,300 households) and that approximately €22 million could be saved in 2012 by abandoning Norway Post’s bank obligation and its obligation to maintain a pre-defined number of post offices. Based on this, the Norwegian Government has decided to reduce the bank obligation in 2012.

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The Swedish Post and Telecom Agency (2010), *Grundläggande betaltjänster – delredovisning av regeringsuppdrag*
A gravity model of international postal exchanges

By José Ansón and Matthias Helble

In spite of the intensification of international trade exchanges over the last three decades of globalization, very little empirical research has been conducted on the drivers of international postal exchanges for different classes of mail. A better understanding is needed regarding what hinders the development of cross-border postal items.

The paper tests whether the standard gravity equation theory holds for international postal exchanges or not. In its standard form applied to international trade, the gravity approach explains bilateral trade between two countries as a function of the geographic distance between both and their relative income and populations (i.e. the more reduced distance is, and the bigger the two trade partners are in economic and demographic terms, the larger trade flows between both is expected to be). The effects of structural constraints, often referred to as trade frictions, can then be tested by introducing additional explanatory variables such as tariff and non-tariff barriers, or other variables measuring a variety of frictions according to the purpose of the research. The gravity equation is usually estimated using panel data econometrics. Furthermore, this empirical framework is established on solid microeconomic theoretical foundations provided by Anderson and van Wincoop (2003, 2004).

The basic postal gravity equation will not only rely on distance and relative economic weight of postal partners as in the classic trade gravity equation, but also on the relative reach of their postal infrastructure as measured by the relative postal network size and density. Indeed, the larger and denser the postal networks in two partners countries are, the higher the number of cross-border postal exchanges is expected to be. A full postal gravity equation will then help distinguish the impacts of potential postal frictions from other traditional trade frictions in order to identify the major obstacles to the development of international postal traffics. Among postal frictions under consideration, different systems of remuneration of termination services, quality of service, availability of return services, inquiry and complaint management, and network alliances will be examined for different classes of mail items (letters, parcels, express) in different versions of the postal gravity equation. A dataset comprising billions of records on bilateral postal exchanges between countries will enable econometric estimations with high frequency data, a premiere for gravity equations. The estimation of the postal gravity model will provide key trade and price elasticities, and take advantage of the unique heterogeneity of Posts across the world.

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Provision of International Mail Services in the 21st Century

John Hearn (formerly Project Manager Postal Regulation, ComReg) and

A N Other (Senior Manager, Postal Regulatory Policy, ComReg)

For the past quarter of a century the debate has centered on the level and structure of Terminal Dues for Letter post and how to control the opportunities the current system gives to arbitrageurs to distort domestic letter post markets. At the same time a competitive market for international express and parcel services has developed based on seamless global networks and cost orientated network sharing agreements. However the impact on international mail services (letters and parcels) of e-substitution, increased demand for e-fulfillment services, emerging hybrid mail models, market liberalization, access to domestic delivery networks, the emergence of new operators and the development of global and regional delivery networks has been largely ignored.

This paper considers the framework necessary to support the services that customers will need over the coming decades in terms of stakeholders (sales organizations, network managers, delivery companies), how these will inter-act with one another, and the types of international and commercial agreements that will underpin their operations. The convergence between international and domestic access agreements will also be considered.

Specific issues to be covered include:

- The different obligations under EU legislation and the UPU Convention.
- The nature of bi-lateral and multi-lateral agreements within the EU.
- The problems of translating non-linear domestic tariffs into linear Terminal Dues / Inward land Rates / Access charges.
- Possible convergence between Terminal Dues and Domestic “Access” pricing.
- The focus on quality as much as price.
- The emergence of global and regional networks.
- Granting access to non- Designated Operators.
- Differing approaches in the Letter and Parcel markets.
- Funding “below cost” delivery charges offered to developing countries under inter-governmental agreements.
Termination Charges in the International Parcel Market

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Abstract

There is a broad theoretical end empirical economic literature discussing the effects of termination charges on competition and retail prices. Most of this literature has focused on the telecommunications markets. Termination charges in the international parcel market have not yet received much attention in the economic literature. The aim of this paper is to fill this gap and to analyze the economics of termination charges for parcels. We find that the economics of termination charges in the international parcel market are different to termination charges in other markets.

To assess the economics of termination charges in the international parcel market this paper takes three steps. First, a basic outline of the current structure of international parcel markets is presented and existing international termination systems are explained. Second, the literature on termination charges in the telecommunication market is shortly summarized and the crucial differences of the international parcel market to telecommunication markets are elaborated. Third, two game theoretic models are constructed to assess the economics of termination charges. It is found that postal operators are in a “prisoner’s dilemma” where bilateral bargaining processes are likely to result in a suboptimal situation with excessive pricing and underinvestment in quality. When accounting for quality, termination charges in the international parcel market are optimally set very differently to access charges in the telecommunication market.

Keywords

parcel market; international termination charges; access; remuneration system

JEL classification

D40; F19; L50; L90
Abstract for the 20th Conference on Postal and Delivery Economics

“Social regulation of the postal sector”

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The postal sector is in a period of rapid transformation with technological changes, liberalization, and declining letter mail volumes. The results of these changes on the social sphere both in terms of employment are significant. Given the changes, postal workers are increasingly subjected to uncertain work lives, lower wage rates, more precarious forms of employment and declining working conditions (Bickerton, 2006; European Social Dialogue Committee, 2010; Schulten, Brandt, Hermann, 2008; European Foundation for the Improvement of Living and Working Conditions, 2005).

This paper will highlight the need and value of social regulation in the postal sector to address the impact of changes on employment. Social regulation as an idea is becoming increasingly discussed, especially where postal markets are being liberalized in accordance with EU Directive 2008/6/EC and amending directive 97/67/EC. The Post Social dialogue committee of the European Commission has been playing a role in the evolution of this concept (Project: Social partners preparing for change, 2010, p. 6). At the same time, the concept needs to be explored on a global level. A more thorough discussion of approaches to social regulation, especially those that promote decent work is necessary at this juncture.

The social regulation of employment can come through effective collective bargaining regimes in the postal sector – either company-based or by sector; or through minimum standards legislation in terms of employment conditions and occupational health and safety at the national level; or through regulation governed by regulatory bodies that oversee the postal sector (Project: Social partners preparing for change, 2010, p.19; Schulten et al., 2008, p. 307-309). Most often, social regulation occurs through a combination of these national approaches. In addition, where regional integration has occurred such as in the European Union, social regulation can also exist at a regional scale. These responses at the national and regional level are of the utmost importance; however, this paper will argue that a purely national (and regional) approach is no longer sufficient given the global nature of multinational postal companies (Murray & Trudeau, 2004). The paper will argue an international level of social regulation needs to be implemented through Global Framework Agreements between multinational postal companies and global union federations as well as strong social regulation recommendations from international organizations such as the World Trade Organization and the Universal Postal Union. This social regulation should be based on internationally recognized labor and human rights conventions, especially principles covered in International Labor Organization conventions, declarations and practices. A multi-pronged approach to social regulation will help ensure decent work and a level playing field in a fast-changing and global industry. It will ensure that competition occurs on the basis of innovation rather than social dumping. At the same time, the paper will reinforce that particular regulatory incarnations will of course be rooted in the domestic context and reflect the particular labor relations and employment system in place.
This paper will attempt to draw up general principles of social regulation that can be applied to the global postal sector. The paper will be informed by case studies from different postal markets. The paper will be divided into three sections: the first will discuss the changes within the postal sector, which are impacting employment; the second will outline current approaches to social regulation; and the third will argue that a multi-pronged approach to social regulation at the national, regional and international level is imperative to maintain decent work in the sector.

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Universal Postal Union. Action and innovation paving the way to Doha and beyond. UPU Strategy Conference. Nairobi, Kenya, 22–23 September 2010
Abstract paper for Rutgers conference 2012
From CWU UK/Ireland
Natalie Jacottet, Steve Fitzpatrick, John Baldwin and Emmanuel de Lange

Regulatory Failure-The UK Experience

The postal sector has been in a state of permanent change for the last two decades. The widespread use of electronic communication and the increasing opportunities afforded by ecommerce have served to highlight the challenges facing all stakeholders in the sector. The reduction in volumes of letter mail, caused by electronic substitution and the global economic downturn has worsened the already fragile nature of the tried and tested business models that characterize the sector. The traditional systems of integrated and coordinated postal services, including cross border, have been radically altered by a combination of the diversification activities of the National Postal Operators and the liberalizing of postal markets. The increasing difficulty of providing universal services at an affordable price, coupled with the reductions in volume of letter mail have introduced a fundamental dilemma that did not previously exist.

The basic question is; how to continue to provide quality services at affordable prices delivered by a committed and reliable workforce whilst the opportunities to benefit from economies of scale decrease. Our paper will aim to address the challenges and offer a range of potential solutions by reference to the available data. We will focus on the various business and employment models currently in play. We will rely on the following:

- the cost of providing the USO reports conducted in Europe and globally
- the social observatory established by the EU Post Social Dialogue Committee
- the various studies of all aspects of the postal sector conducted in Europe on behalf of the European Commission, National Operators and trade unions
- the various studies conducted by UNI and postal trade unions on a global basis
- the papers presented at previous Rutgers conferences
Network operators typically use quite sophisticated pricing policies. For instance, nonlinear pricing (second degree price discrimination) has a long tradition in the telecommunication and energy sectors. Similarly, in these and other sectors, prices are often differentiated according to market segments (third degree discrimination). Even though it is not the most prominent textbook example to illustrate such pricing policies, the postal sector is in fact no exception. Ramsey pricing is effectively a form of third degree price discrimination. In addition, most postal operators have volume discount programs (a form of nonlinear pricing). While regulators and competition authorities are often reluctant to accept these practices, economists tend to view differentiated pricing policies in a more positive way. For a regulated operator, they are an effective way to cover fixed cost while mitigating distortions that would be associated with straight linear pricing. When the regulatory policy is well designed, sophisticated pricing policies can of course only be welfare enhancing. However, when there are regulatory failures or when the market is partly or totally deregulated, this is no longer necessarily true. The scenario where a profit-maximizing operator may engage in pricing policies that are detrimental to welfare can then no longer be ruled out. Still, the literature has shown that departures from linear pricing are often welfare enhancing, even when the operator is profit maximizing.

The implications of differentiated pricing policies for the postal sector have received little attention in the literature. A notable exception is Crew and Kleindorfer (2011) who study the implications of volume discounts. They show that nonlinear pricing can contribute to the financial viability of an operator who faces market opening and intermodal competition (in particular from electronic media). In this paper we study pricing policies, which combine market segmentation (third degree price discrimination) with nonlinear pricing (second degree price discrimination) and which are referred to as segmented nonlinear pricing (SNLP). More precisely, we assume that the operator can group customers into a certain number of categories on the basis of an exogenously observable characteristic at no cost. Under standard third degree discrimination, the operator charges linear prices that differ across categories. Under SNLP, the operator can use category specific nonlinear tariffs. This is a common practice for telecommunications (particularly mobile phone) and in airlines where different menus of tariffs are offered to the young, the students, or the elderly or where
professional customers are treated differently from households. In the postal sector, SNLP has a number of potential applications. In particular, it could be used to improve the design of volume discounts by targeting them to the categories of customer who are most likely to switch to electronic substitutes. While our analysis provides a methodological contribution that goes beyond the postal sector, we focus our attention on specific postal issues. This is reflected in our illustrative examples but also in our modeling assumptions. In particular, we include the feature that customers always have the option to use the public stamp rate (reservation utility is determined by a linear tariff and is thus type specific).

The design of nonlinear tariffs is first and foremost an issue of asymmetric information. The operator does not observe the individual customer's willingness to pay. Under full information, the operator would induce an efficient allocation. This is because it can extract the entire surplus and thus chooses a policy to maximize it. Under asymmetric information, there is a tradeoff between rent extraction and efficiency and quantities are distorted (typically downward) to mitigate informational rents. Under SNLP, the operator observes the customer's category, which provides some information about the distribution of his type (willingness to pay). More precisely, it can use the intra category distribution of types (rather than the overall distribution) to offer segment-specific tariffs.

We characterize the solution under SNLP in a simple four types, two categories setting and compare it to the standard NLP solution (as well as to the outcome under linear pricing). We provide a set of sufficient conditions under which SNLP (used by a profit maximizing operator) is welfare improving. When these conditions are violated, a welfare improvement continues to be possible but whether it materializes depends on the preference and cost structure. For either case, we use numerical examples to study the impact of the pricing schemes on the various customer groups and on the operator's profit.
Welfare and pricing with single piece and bulk mail access competition in the postal sector:

P De Donder, H Cremer, P Dudley, F Rodriguez

When direct ex ante regulation is withdrawn and replaced by ex post regulation, it is often accompanied by greater regulatory information requirements including accounting separation and transfer pricing. Transfer prices indicate internal charges levied by one part of a vertically integrated business to another part of its business. This information is then used by the business to inform pricing decisions, and by the regulatory authorities to assess whether behaviour by a dominant party amounts to an abuse of that dominance. In general the transfer prices would be expected to have similar characteristics to the access prices offered to third parties, where those access prices exist, and to reflect what market access prices might look like were they to be offered to third parties that currently do not exist in the market place.

In the latest European Directive single piece mail is distinguished from bulk mail and permits the single piece mail to be the subject of ex ante price control regulation. Single piece mail comprises of social and business mail, and there is the option for bulk mail market to include access to the incumbent operator’s network.

In the postal sector, De Donder et al (2008) looked at the cases where the incumbent Postal Operator (PO) comprises a Mail Network Operator (MNO) with a single good for the single piece market and an access good (for both urban and rural zones) in the bulk mail market, and Retail Business (RB) selling a bulk mail (BM) good (for both urban and rural zones) with a competitive fringe in bulk mail. The paper assumed welfare maximisation subject to break even and looked at the effect on welfare and pricing of different breakeven constraints and pricing rules on the PO, MNO and RB, including the effect on urban and rural access prices in the BM market.

In this paper, we introduce a transfer price for single piece business mail (SPB), reflecting what market access prices might look like were they to be offered to third parties, and an access price in the BM market, and we look at how they relate to one another under different market assumptions. We start our analysis assuming the incumbent has three end-to-end goods (single piece social mail, SPB mail and BM) and two access goods for SPB and BM. We assume that there is imperfect competition in the upstream bulk mail and upstream SPB mail markets, and we
exclude geographic zones to focus on the SPB transfer prices and BM access prices. We show how different cost and demand assumptions, breakeven constraints and pricing rules affect welfare and pricing, and in particular the relative access prices for SPB and BM. We then look to extend this analysis to one in which the incumbent has introduced a further distinction within SPB and BM and with corresponding access goods in SPB and BM. We calibrate the model to gain numerical results and provide further insight.

In summary the presence of digital and postal competition, the withdrawal of ex ante regulation may lead to accounting separation and transfer pricing and this paper analyses what transfer pricing could look like under different market conditions.

References

Postal Conference Paper – abstract

Ofcom’s new regulatory regime – potential future scenarios for Royal Mail

Authors: Phil Burns, George Houpis, Steven Tokar.

In October 2011 Ofcom, the body which now regulates Royal Mail, published its consultation document “Securing the Universal Service”. The consultation document describes the issues facing Royal Mail and outlines Ofcom’s proposals for the future regulation of Royal Mail. Our paper will consider the likely impact of the proposed regulation on Royal Mail and the future of the universal service obligation (USO) in the UK.

In our paper we first describe the recent developments in the UK, describing Royal Mail’s financial troubles, the changes to the regulatory structure in the UK and Ofcom’s regulatory proposals. We then present one of the first analyses of the potential impact of these regulatory changes, discussing how prices may change and the incentives for Royal Mail to increase efficiency.

In relation to pricing, we examine demand-side constraints and whether the reduction in regulation may lead to price increases, or whether the constraints imposed by different customers’ ability to switch away from Royal Mail to postal and non-postal alternatives will restrict price increases. We also examine whether the threat of entry may constrain price increases, considering the potential for successful entry/expansion in the upstream (collection and sorting services) and the downstream (delivery services) sectors.

The paper will also discuss how the regulation may affect Royal Mail’s incentives to increase efficiency and maintain the USO, considering the evidence from Royal Mail’s past efficiency drives, the Ofcom proposals and what insights can be derived from relevant economic theory.

Our work in this paper is related to many recent postal papers. For example, Jaag and Trinker (2010) discuss the future of the USO, Wojtek and Zauner (2010) discuss the impact of regulation on postal prices and Cazals et al (2010) discuss efficiency in the postal sector. Our contribution in this paper is to draw these themes together to provide a comprehensive discussion of the likely impact of the changes in the UK, which should be of interest to operators, regulators and those studying the postal sector.


1 Cazals, C., Florens, J.-P. Dudley, P. and Jones, M., (2010), ‘A Panel Data Analysis of Inefficiency and

The views expressed in this paper are those of the authors and not necessarily those of Frontier Economics.
Abstract Proposal for Rutgers Conference

Title: The economic impact of the Canadian postal strike and lock-out: Permanent economic damage or temporary inconvenience?

Submitted by Katherine Steinhoff and Geoff Bickerton
Canadian Union of Postal Workers

This paper will examine the economic impact of the four week disruption in postal services which occurred in Canada during June 2011.

In early June 2011, the Canadian Union of Postal Workers initiated a series of one-day work stoppages conducted in various communities. After 12 days of one-day and two-day strikes the management of Canada Post Corporation (CPC) announced it was reducing delivery to three days per week. Four days following this announcement CPC initiated a nation-wide lockout which completely stopped the delivery and processing of mail. Immediately following the announcement of the lock-out, the Canadian government announced it would introduce back-to-work legislation. The government claimed that the labor disruption was causing major economic damage. After two-weeks the legislation was adopted. During that period CPC maintained the full-scale national lock-out.

This paper will examine the economic impact of the strike and lock-out. It will review economic and volume data from CPC and the federal government. The authors will also conduct interviews with large volume mailers, charities, and the leadership of small business organizations.

The paper will contribute to the ongoing debate concerning the economic importance of postal services during an age of declining mail volumes and increasing electronic alternatives to traditional letter mail. It will provide a unique perspective on the actual economic consequences of a major curtailment of postal services. It will also contribute empirical data to inform the public policy discussion concerning the relevance and requirement for the Universal Service Obligation.

The paper will be of general interest to economists, academics, political leaders, and trade unionists.
Abstract for the 20th Conference on Postal and Delivery Economics
“Correios in Brazil: New Challenges”
D. M. Levy (Venable LLP) and B. H. Levy

Empresa Brasileira de Correios e Telégrafos (“ECT” or “Correios”), the state-owned USP in Brazil, is the largest postal operator in Latin America and one of the most successful among middle-income countries worldwide. ECT provides door-to-door mail delivery to about 80 percent of the households in a country of 203 million people dispersed over an area slightly larger than the lower 48 states of the U.S. Ianni (2008). ECT retains a legal monopoly over traditional letter mail, small parcels, telegrams and mail bags.

ECT earns a profit, in large part thanks to successful forays into non-postal and international markets. These include retail banking, e-commerce, international express delivery, consumer bill payment services, and back-office services for other government agencies and private businesses. In the past few years, however, ECT’s business model has come under pressure from several directions. First, the creation of an independent regulatory agency has been proposed to oversee the rates and practices of ECT for its monopoly services. Second, others have proposed to sunset ECT’s monopoly over traditional letter mail, small parcels, telegrams and mail bags. Third, ECT management fears that ECT will soon begin to lose volume and revenue to the Internet and to large multinational logistics companies.

On September 16, 2011, the President of Brazil approved Law No. 12,490, which authorizes ECT to offer a broad range of new non-postal services (including email, integrated logistics and new financial services); open offices and begin operations abroad in competition with large multinational logistics companies; and carry out these initiatives by establishing subsidiaries, forming partnerships with private businesses, and buying private companies. Postal labor, fearing that the legislation would lead to privatization and outsourcing of work, responded to the legislation by calling a nationwide month-long strike in September and October. Although the strike was ended by court order, the potential for recurring labor-management conflict remains as the scope and form of these new ventures are fleshed out.

The objectives of this paper are to (1) assess the risks created by ECT’s expansion plans—particularly the risks that its planned entry into new product and geographic markets will squeeze out more efficient competitors, generate losses that must be subsidized by taxpayers or mailers, or create opportunities for rent-seeking; (2) discuss how ECT
can deal with those risks most effectively; and (3) consider the implications of ECT’s experience for postal operators in other countries. These issues may interest postal operators, regulators and government officials in Brazil and other middle-income and advanced economies. The paper will be policy oriented, and will rely in large part on primary documents in Brazil.

This paper would fill a gap in the literature. CRRI has published several papers on postal economics and reform in Latin America and developing countries generally (Ansón et al. (2006), Ansón and Toledano (2011), Kenny (2006) and Ianni (2008)), and the UPU has published a paper on postal banking in Brazil (Ansón and Gual (2008)). The English-language literature, however, does not appear to include any paper on ECT as a whole, or the policy implications of ECT’s current market entry plans. The authors have not written about these topics before.

REFERENCES


ABSTRACT

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The role of the social capital in the postal operators’ diversification choices

Within the framework of the combined market opening and the development of new technologies, the decrease of the mail volumes creates an increased pressure on postal operators to modernise their infrastructures and work organization but also to diversify the activities in order to find new revenue areas. In view of the decrease of their core traditional business, diversification seems to be recognized today as the best way forward for operators to ensure their sustainable economic development. Within such a labour-intensive sector, the diversification choices are deeply linked to economic but also social considerations from a double perspective. On the one hand the transformation of the activities has important social consequences in terms of the evolution of employment and competencies that should be correctly managed. On the other hand the operators’ potential in terms of human resources could be considered as a strategic criterion of diversification. Based on these considerations, the article aims at better understanding what the role and weight of the human capital is in the operators’ diversification choices. This question is a particularly complex one as it raises interdependent economic and social considerations.

Two projects within the framework of the Social Observatory put in place by the European Social Dialogue Committee for the postal sector enable to better understand the reality of the social impact of the current sector transformation in most EU Member states. The scope of these projects conducted in 2009 and 2011 is quite large but the fresh first-hand data collected is a good basis for illustrating our article with relevant concrete examples.

This article suggests analysing the interrelation between diversification and the human capital through three steps. In a first part it will present the reality of the social impacts of the current evolutions and explain why while these evolutions require important changes they have not led until now to a structural collapse or a deep restructuring within postal operators. Indeed it appears that in quantitative terms, the general decrease of employment is often managed by natural attrition and mobility while in qualitative terms, the adaptation of the form and nature of employment is limited. In a second part the article will analyse in a comparative way, the link between the different diversification choices and the extent to which the social optimisation is used as leverage. As shown by several studies, it appears that the less diversified a postal operator is the more important social impacts are. In the absence of new revenues the social optimisation is used as a main element to decrease costs. Diversification enables, therefore, the operators to be protected better from the risk of a radical social transformation. In the last part the article will explain why, despite the current uncertainties, the social dimension and innovation should be a driving force of the diversification choices made
by postal operators. The emerging trend towards a customer driven diversification calls for an increased use of non-physical assets as levers of economic development. The social dimension which is a founding element of the postal sector culture is one of these important assets.

To sum up the article aims at enlightening that while no postal operators can avoid an adaptation of its social model, this social impact is limited. It is though more intense within operators which have chosen a limited diversification or which are engaged in a diversification path which does not take into consideration the human capital as a key driver of diversification. The social adaptations (or impacts) are more important within operators with a limited diversification of their activities or which diversify without sufficiently considering quality of employment as being a main lever of their diversification.
Estimating long run incremental costs in the postal sector:

A UK perspective

L Mautino, P Dudley, J Prettyman, F Heagney

In the UK, the presence of both digital and postal competition has led to proposals to reduce the levels of ex ante regulation, and move towards ex post regulation. This has been accompanied by a greater emphasis on the provision of information by the universal service provider. This provision of information includes the estimation of the long run marginal or incremental costs in the UK that will ensure that greater deregulation, commercial freedom and innovation is accompanied by good business management practice that leads to efficient and economic operations and competition, while also ensuring the provision of the universal service.

The European Commission guidelines for assessing anti-competitive behaviour of a dominant firm in any sector include reference to long run incremental cost estimates as one of the relevant cost benchmarks. In general, prices that recover these costs are considered to be reasonable and prices between long run incremental costs and average avoidable costs may be reasonable dependent on the circumstances. These cost benchmarks have been applied in several sectors and, in the postal sector; they have been referred to in some EU decisions.

The decline in mail volumes has changed the dynamics of cost marginality. Colvin et al (2012) showed the short run marginality is asymmetric and lower when mail volumes decline. Cazals et al (2012) showed that the long run marginality using cross sectional analysis in delivery is larger than shorter term marginality.

In this paper, we first review the literature on long run marginal costs and the adaption and generalisation of that to long run incremental costs for firms, and particularly firms in network industries. We review the approaches to long run incremental costs developed and applied in other sectors to post, and look at their use in the postal sector to-date. This includes consideration of starting from incumbents and entrant costs for estimating the incremental costs, and the implications of the different approaches.

We then set out the development of an approach to estimating the long run incremental costs in the UK from the perspective of the universal service provider. This includes reference to the principles being adopted for its development. It also includes reference to the drivers of cost and other factors in the postal sector that need to be taken into account to identify appropriate long run incremental costs to inform pricing and business decisions. Furthermore, it includes consideration of how changes to the network operation and mail volumes affect the estimation of long run incremental costs within the postal pipeline.

In the UK, the decline in mail volumes is accompanied by substantial changes to the network operation as well as regulatory change towards greater deregulation, commercial freedom and innovation. Consequently, it is a particularly appropriate time to review long run incremental costs and to consider how they could be estimated in practice.
In the context of the liberalization of the postal sector, a lot of attention is devoted to the control of anticompetitive practices that could be deployed by incumbents to deter entry. As shown by Crew and Kleindorfer (2003) the original concern was that “the incumbent regulated monopolist might employ its regulated monopoly to the disadvantage of competitors”. Today, it seems that the concern is even broader and the situation where a firm simultaneously provides commercial and public services is also put under scrutiny. The need to address this conjecture that regulated firms or firms providing a SGEI are more likely to adopt anticompetitive strategies is particularly timely for postal operators. First, in a recently published draft\(^1\), the Commission considers that an SGEI is susceptible to distort competition even in the absence of overcompensation. Secondly, the proper test of predation for postal operators is currently under discussion\(^2\).

In a first section we will address the “level playing field” arguments. These arguments mainly rely on the idea that a firm providing a regulated service or a SGEI benefits from economies of scope unavailable to competitors. We show that these economies cannot distort competition if they are taken into account when computing the compensation of the SGEI.

In a second section we will address the arguments related to the “cross subsidy” notion. We first show, relying on examples from the postal sector, that the notion of “cross subsidy” is often confused with the issue of “cost misallocation” [for example described by Brennan (1990)]. Secondly, the “cross subsidy” notion as defined by Faulhaber (1975) is often misunderstood. Finally, we show the lack of foundation of the “deep pocket” argument applied to postal operators.

In the last section, we study the incentive of diversified regulated firms to adopt anticompetitive strategies. We build on the analysis of Sidak and Sappington (2000, 2003 a, 2003 b) who consider two ways for a firm to predate despite the supervision of a competition authority. The first one is to “hide” the predation by misallocating its cost; the second one is to adopt an inefficient technology that will decrease the incremental cost of the predatory product [see Panzar (2008) for possible applications in the postal sector]. Sidak and Sappington study the incentive for operators to adopt these strategies under the hypothesis that public firms maximize revenues instead of profits. Crew and Kleindorfer (2003) show that this analysis is flawed, because a realistic description of price setting in the postal sector has to take into account the regulatory process. We model this regulatory process and show how regulation can modify the incentive to adopt anticompetitive behaviors\(^3\).

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\(^1\) Draft Communication from the Commission: EU framework for state aid in the form of public service compensation (2011)

\(^2\) See the opinion of the advocate general in Post Danmark vs Konkurrencerådet, 24 May 2011.

\(^3\) We also improve the analysis of Sidak and Sappington by modeling a strategy consistent with the “financial theory of predation” [Bolton and Scharfstein (1990)], and by modeling an endogenous probability of condemnation by the competition authority.
Postal markets are characterized by high economies of scale in delivery and by a demand that follows a Pareto distribution, with few large customers accounting for the majority of postal flows. With decreasing postal volumes, competition will take place in a shrinking market where, arguably, electronic substitution may lead to permanent increases in price sensitivity, and may therefore accelerate the speed at which volumes fall.

It is within this framework that access prices and volume rebates need to be considered. On the one hand, vertically integrated incumbents with a dominant position in the upstream (access) market are capable of preventing their downstream competitors, which are not integrated, from earning viable price-cost margins. On the other hand, these same vertically integrated incumbents have to be able to support a network where large fixed costs (as labor costs for most of the incumbents are) translate in increasing unit costs due to volume reductions.

In general, there are three sets of anti-competitive incentives for incumbents to engage in price squeezes:

1. To monopolize or reduce the competition in, the downstream market (Salop and Sheffman, JIE 1987);

2. To uphold or restore market power upstream (Rey and Tirole, Handbook of IO, 2005); and,

3. To engage in what is called "defensive leveraging" (Carlton and Waldman, RAND JE 2000)

There are also a number of justifications for the pro-competitive effects of such a conduct, in terms of dynamic pricing when there are switching costs, network externalities or reputational effects; and static and dynamic efficiency.

Most analyses of margin squeezes in regulated markets have occurred in the context of markets where output is increasing, such as telecommunication markets.

In this paper, we propose to analyze traditional tests for margin squeeze (which are based on differences between retail prices, wholesale prices and downstream costs), and whether these tests need to be modified, from an economics and accounting perspective, to account for the relationship between downstream costs and falling volumes.

We will also consider whether welfare gain from increased postal flow through retail rebates more than outweigh losses from not extending such rebates to access customers, and in particular, to consolidators.
Social Media challenges the whole postal industry

Internet penetration has rapidly increased all over the developed world. Internet household penetration was 70% in the EU in 2010 (Eurostat 2011). 89% of all Finns and 99% of 16–50-year-olds use internet today, and in addition 60% of these use it many times daily (Statistics Finland 2011). This means that the internet has become an absolutely necessary channel in daily use for information retrieval, news follow-up and communication. This has caused mail volumes to become a falling trend nearly everywhere, advertising to increasingly digitalize and newspapers and magazines to be read to an increasing extent in a digital format. Consequentially, at the same time, postal organisations providing traditional paper-based communication services will be faced with cost and profitability problems.

The most significant feature of the future media will be globalisation. This new media will rarely be under the control of a single owner and when the media compete with each other a new communication dynamics will develop. Tools such Facebook and Twitter have brought people closer together and created new online communities. In these communities it is important to create information that binds group members to each other. At the same the flows of information will be filtered, and this in turn will steer consumers’ attention to those goods, services and news which may interest them. This type of socially filtered media use threatens traditional professional journalism even today. In the first place, it presents a challenge to the delivery and reading of printed newspapers and magazines. For example, in Finland the number of delivered newspapers has decreased 10% since 2008. During the same period the decrease in magazines has been 15%.

Although 62% of Finnish consumers still prefer traditional professional journalism, there are now already 13% who prefer socially filtered media use (Elkelä 2011). Those who prefer the social filter are mainly in the younger age groups and their share seems to be growing rapidly. Our research also found that socially filtered media use is accompanied by substitution of paid newspapers by internet and free papers. Many social media users also express a cynical attitude towards the professional media.

This change has not only affected the use of the printed media, but also influences willingness to send and receive letters, postcards and advertising leaflets. This is presenting a major challenge to the postal industry as a whole.

The results are based on several consumer surveys and in-depth interviews conducted between 2007 and the present day (Keränen et al., 2008, 2009 and 2011; Elkelä et al., 2010; Elkelä, 2011). The quantitative data has been examined using cluster, main component and regression analyses.

This paper considers the substitution of traditional paper-based communication by the totally new ways of communicating and consuming media content and evaluates what this means for postal organisations as well as the whole of the postal industry. This study is of international significance, because social media use quickly diffuses along with internet penetration growth and will have a considerable global effect on communication behaviour during the next 5–10 years.

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Measuring consumer preferences for postal services
C. Rohr\textsuperscript{1}, U. Trinkner\textsuperscript{2}, A. Lawrence\textsuperscript{3}, C.W. Kim\textsuperscript{1}, D. Potoglou\textsuperscript{1}, R. Sheldon\textsuperscript{3}

Post services have steadily evolved over centuries as the key means for long-distance communication between people. Every year European consumers hand over about 135 billion postal items to postal operators, who deliver them throughout the European Community. However, the postal sector is facing a series of challenges calling for significant transformation. The past decades have brought about a rapid development of new communication and information technologies which have an impact on consumers’ needs and priorities for postal services. Some of these technologies have had the role of replacing more traditional mail services, and have led to pronounced erosion in postal volumes, whilst others have spurred the growth of certain market segments, like parcels and small packets. In the case of regulated services, like postal services, such developments in consumer demand are not immediately matched by changes in supply – they must be identified and addressed through policy decisions. It is therefore vitally important that policy makers understand consumers’ needs and preferences for postal services.

This paper aims to contribute to a better understanding of consumers’ needs by developing a methodology for measuring consumer preferences in the two-sided postal market, based around stated preference discrete choice experiments, and reporting the results of its implementation in the three member states Italy, Poland and Sweden. Within the choice experiments we examine a wide range of postal attributes, focusing on attributes ‘experienced’ by users, such as access to services, speed of delivery, reliability, delivery and network characteristics. We examine differences in preferences by businesses and resident consumers, taking account of size of business and resident vulnerability, by postal commodity (letter or parcel services), by usage patterns (senders or receivers) and by degree of digital competition.

The research adds to the growing body of research on consumer priorities in the postal sector. It provides a somewhat different focus than other work in this area, in that it focuses on attributes directly experienced by users, rather than for more operational features, such as frequency of collection or delivery. It also provides comparisons of postal priorities for businesses, separately for SMEs and large businesses, and resident consumers, separately for vulnerable and non-vulnerable residents; and across member states. Lastly, it explicitly examines the impact of usage patterns (degree of sending and receiving) and digital competition on consumers’ valuations of postal attributes.

This research is likely to be interesting to operators, regulators and others who are interested in better understanding consumers’ preferences for postal services.

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Abstract for the 20th Conference on Postal and Delivery Economics
“Estimation of Consumers’ Priorities for Quality-of-service in Post: Recent Evidence from France”
Postal services are subject to dynamic forces making their governance an on-going challenge. In particular, governance of the USO quality of service is challenging; noting that postal operators are subject to increasing pressure, how should quality-of-service governance evolve as consumers’ needs change?

This paper studies the priorities of postal consumers in France. The paper is timely and relevant as it aims to help policy makers, government administrations, regulators, and posts treat questions of cost saving and quality in a context of market liberalization and electronic substitution.

The paper is based on a study done by London Economics/IPSOS for ARCEP/DGCIS.

We use an ordered logit econometric model of consumer satisfaction – individuals, SMEs and socio-economics actors - to estimate the relative importance of various service qualities attributes. The paper is based on data from a survey run in two waves in France in late 2010 and early 2011. Service elements treated include: price and delivery time of first-class and registered letters, and standard parcels; mail distribution time, latest mailing time, physical integrity of letters and parcels, delivery reliability, and the waiting time at the post office. The analysis controls for the socio-economic characteristics of the survey respondents and examines the extent to which the results vary with survey respondents’ knowledge of postal products.

Interestingly, our paper suggests that consumers’ overall satisfaction levels are not always significantly determined by what they rate as high priorities individually. This has implications vis-à-vis previous studies, such as Postcomm (2009) and Sheldon and Lawrence (2010), which looked at consumers’ preferences for a variety of USO elements.

The paper is original in that we combine analysis of priorities with an econometric model of overall satisfaction. Our conclusions suggest that policy makers, government administrations, regulators and stakeholders should consider both consumers’ individual quality priorities and overall satisfaction when considering quality-of-service evolutions.

References


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4 The French regulator and Ministry for the Economy, respectively. A summary of the study can be found at http://www.industrie.gouv.fr/poste/pdf/synthese-etude-postale.pdf and a comprehensive description and history of the tools and measures of quality-of-service in France can be found in Cecchet (2011).
In world of postal and delivery services, the most significant issue today is the fate the U.S. Postal Service (USPS). USPS accounts for about two-fifths of the world’s mail, yet its financial situation has become perilous. Even if USPS never repays the government some $20 billion in outstanding debts, it will run out of cash by next fall. Underlying and underscoring these financial woes, the core business of USPS, collection and delivery of letters and advertisements, is deteriorating rapidly.

What can be done? In recent testimony to Congress, Postmaster General Pat Donohoe declared, “This cannot be a short-term fix. We have got to not only look at revenue to 2020, we have got to look at revenue out beyond that and make sure that . . . we resolve this issue now, and we give the Postal Service the business flexibility to manage going out into the future.”

The objective of the proposed paper is to outline a plausible answer to the Postmaster General’s plea for viable long term reform.

The starting point will be John Panzar’s paper for the 2011 meeting of this Conference in Jersey. This paper provides an admirable conspectus of policy and regulatory options for organizing the “Postal Service of the Future” (PSF). The paper concludes that PSF should continue as a state-owned enterprise (SOE) but confined to its “core competency,” delivery of letters and parcels, possibly fortified by a legal monopoly. While agreeing with much of Panzar’s characterizations of the policy tools at hand, the proposed paper will consider several points more specifically and arrive at somewhat different conclusions.

First, the proposed paper will argue that there are significantly different kinds of SOEs, that the structure of an American SOE is fundamentally shaped by constitutional considerations (particularly the Appointments Clause), and that the specific form of SOE substantially affects the choice of policy options.
Second, the proposed paper will consider the legal and political roots of the Postal Service’s current financial crisis and argue that these factors, too, should weigh heavily in designing a new governance structure.

Third, the proposed paper will more explicitly consider implications of the rapidly changing nature of the traditional postal market.

Fourth, the proposed paper will draw upon lessons from a wider range of regulatory precedents — including foreign postal reforms and reforms in additional non-postal sectors in the United States — to refine the policy options identified by Panzar.

In the end, the proposed paper will seek to identify an approach towards long term postal reform solidly grounded in American regulatory precedents, including the Postal Reorganization Act, while at the same time benefitting from lessons to be learned (and errors to be avoided) from experiences in other countries and other sectors. Like Panzar’s analysis, the paper will focus on appropriate rules for governing the Postal Service rather than correct strategies for managing the postal business.
References

As illustrated by the reference list for John Panzer’s 2011 paper, this paper will draw on the insights of a large number of postal policy papers published within the Conference and outside. However, to provide a better sense of the proposed paper, some papers and studies that presently appear particularly relevant are identified below:


Privatization of Postal Operators: Old Arguments and New Realities

M. A. Crew and P. R. Kleindorfer

Privatization of the postal sector has taken on significant momentum with the passage of the Postal Services Act of 2011, which enables the privatization of Royal Mail. Just as in the 80s when the UK privatization of other network industries and associated regulatory reforms energized these sectors and had an impact well beyond the UK, the current UK proposal promises to have a widespread impact. So, this paper’s re-examination the topic of privatization of an incumbent Postal Operator (PO) with the traditional Universal Service Obligation (USO) would appear to be particularly timely. The 20th Anniversary Conference on Postal and Delivery Economics is an appropriate place to consider privatization drawing a full circle to the original conference at Coton House in Rugby in 1990, in which the discussion was inspired by the contribution of Roland Hill’s innovation of the Penny Post, which provided the basis for a model of a postal system for industrial economies in the 19th and 20th centuries. Now is the time for major reform in the postal sector to reflect the “Communications Revolution”, which is taking place at far greater speed than the Industrial Revolution. If the postal sector is to thrive in the Communications Revolution, further significant transformation of the sector, driven by commercialized and privatized POs will be required to integrate various elements of traditional postal communications with the new communications infrastructure of the Internet and wireless technologies. The form this transformation will take, and the role of private capital in this transformation, requires a careful analysis. This will involve weighing the consequences of various forms of restructuring, including privatization, on fulfilling the PO’s traditional role, and potential expansion of this role to integrate the activities and resources of the PO with broader communications and logistics markets.

Privatization is viewed in the context of existing commercialization of the postal sector. An examination of commercialization concludes that it has limitations in addressing the situation arising out of electronic competition and that privatization is the likely feasible conclusion to commercialization. Electronic competition underlies the entire discussion. Its effect is primarily in eliminating monopoly rents, which necessitates new ways of thinking in the postal sector by POs and by regulators, which are more likely to be provided under private than under public governance. The paper examines the benefits and costs of public and private governance. It concludes that in the current environment despite its flaws, it is the superiority of private governance in facilitating innovation and restructuring means that makes it likely to be a more efficient governance structure than public enterprise.
This paper will explain the main features of the new postal services legislation in the UK, The Postal Services Act 2011, and in particular the new regime of economic regulation of postal services under the Act. This includes a transfer of regulatory powers from Postcomm to Ofcom with effect from 1 October 2011.

The paper will specifically review the provisions of the new Act which implement into national law those parts of the third EU Postal Services Directive 2008/6 which had not yet been transposed. It will compare the UK legislative policy underlying the new Act with the policy concerns of the European Commission and will compare the legislative approaches of the EU institutions and UK government.

The structure of regulation under the new Act will also be compared and contrasted with the approach to regulation under the previous Postal Services Act 2000. The 2011 Act involves a system of general authorizations for postal services operators in place of the previous individual license-based system. Ofcom, the new regulator, can designate a universal service provider (USP) and impose various types of universal service provider conditions specific to the USP, including specific USP access conditions, would require the USP to give access to its postal network to other postal operators and users, and/or to maintain separation for accounting purposes between the different matters relating to access. However, a USP access condition may only include price controls if Ofcom considers that the USP may fix excessively high prices or impose a price squeeze.

Ofcom is also granted competition law powers (concurrently with the Office of Fair Trading) in relation to the provision of postal services, by way of modification of the Competition Act 1998 and the Enterprise Act 2002. This is the first time that the UK postal services regulator has been granted such competition law powers.

The paper will consider the current regulatory position regarding the definition of the universal service and the future price controls on Royal Mail as USP. The current price control regime continues until 31 March 2012. Postcomm and more recently Ofcom have published proposals for the new regime as from 1 April 2012, Ofcom’s most recent proposals being to give retail pricing freedom to Royal Mail, subject to maintaining a single price-controlled universal service, in particular a price cap on stamp prices for second class mail (standard letters). Ofcom further proposes maintaining obligations on Royal Mail to grant access to its network at inward mail centers, without specific access price controls but subject to a margin squeeze test.

The paper will further explain the restructuring reforms concerning the Royal Mail group introduced by the 2011 Act, including the removal of restrictions on ownership of Royal Mail, the possible separation and mutualisation of Post Office Limited and the reform of the Royal Mail pension plan.

15th December 2011
Increased direct and indirect competition in the postal sector represents a great challenge to the traditional business model of postal operators. It is often put forward that regulatory institutions need to evolve in parallel and coherently with developments in the market place in order to allow postal operators cope with these challenges. Such institutions are intended to remedy market failures and reduce transaction costs. However, they also cause governance costs, including costs resulting from distorted investment and innovation, if these institutions do not respond adequately to changes in consumer preferences and technologies.

In previous articles (Maegli et al. 2009, 2010) we developed an analytical framework for the assessment of regulatory governance and its costs in regulated industries. So far, the framework focuses on static effects. In this contribution we amend our previous approach and analyze the impact of regulatory institutions on investment and innovation; i.e. dynamic effects. The main questions we would like to answer in this paper are:

(1) How do regulatory institutions in the postal sector affect incentives for product and process innovation?
(2) What is the way forward for these institutions in an age of increasing direct and indirect competition?

We first present our framework of regulatory governance costs. Then, we systematically discuss the effect of various institutional aspects on innovation in the postal sector, referring to practical examples, e.g. the scope of USO, price regulation or a particular access regime. In our analysis we focus on Switzerland but highlight examples from other European countries as well.

References

Abstract

Year 5 after full Liberalization: Is the postal service in Germany a natural monopoly after all?

Ralf Wojtek

After 14 years of gradual market opening and almost 5 years of full liberalization the German incumbent still holds approximately 90 percent market share in the letter market. A multitude of nearly 650 competitors hold 10 percent of the market, none of them more than 4 percent. None of the competitors’ networks cover the entire area of Germany; all of them must rely on the incumbent to deliver letters to areas where no alternative delivery organization exists. In view of this experience the question must be raised if alternative end-to-end delivery services have a realistic business perspective or if there is only a business case for pick-up services using work-sharing and access.

Contrary to end-to-end delivery services the business of companies offering work-sharing/access (collecting and sorting, delivery through the incumbent, so-called consolidations) is still growing. Customers seem to appreciate the additional service as well as the savings possible through consolidation of mail volumes and volume discounts. The incumbent benefits from consolidators’ sales efforts and customer services which makes letter mail more attractive, as well as from higher volumes on the delivery end. However, without an alternative delivery service the business of the consolidators depends on the ability and willingness of the incumbent to render adequate service at a reasonable price.

The determination of the appropriate access price may be different when end-to-end competition is allowed (as is the case in Europe) as compared to jurisdictions where a delivery monopoly is maintained, as demonstrated by Michael A. Crew and Paul R. Kleindorfer (2008) in “Pricing for Postal Access and Work-sharing” in M. A. Crew, P. R. Kleindorfer and J. I. Campbell, jr., Handbook of Worldwide Postal Reform, Edward Elgar, Cheltenham, UK. In countries with full liberalization the design of efficient pricing rules for access must be competitively neutral rather than preferring one model over the other. This paper addresses the question if it is possible to develop such competitively neutral pricing principles without sacrificing the basic economic efficiency principles underlying access pricing shown by Crew and Kleindorfer.

This paper will argue that the entire letter market has a lot to gain from promoting competition beyond consolidation and work-sharing by eliminating existing barriers to E2E services. Well-meaning regulatory rules and practices – together with outright barriers such as a discriminatory VAT treatment – have stifled competition. Very low access prices have for example, led to an increase in the use of downstream access while at the same time reducing end-to-end competition. The reverse effects are observed where access prices and regulatory barriers to work-sharing are high. A price regulation keeping prices in (de facto) monopoly areas of the letter service high in order to create an incentive for competitors to enter the market has had the opposite effect by generating high profits for the incumbent, while simultaneously suppressing competition if inappropriate access pricing is allowed.
Price regulation of work-sharing discounts and downstream access prices must balance the direct incentives provided by such prices for upstream efficiency against the potential impact of these prices on end-to-end competition. In order to balance these competing sources of value for the postal market, proper regulation requires a proper balancing of interests and access to information. This means that customers and competitors must be allowed to be party to regulatory price decisions that affect them. Such information access needs to be further reinforced by competition law and regulation procedures, accompanied by legal and monetary consequences, in the event of abuse of a dominant position by the incumbent. Without participation rights of competitors and without enforcement rights for the regulator and damaged parties, postal regulation may do more harm than good.

This paper will analyse the recent history of European postal markets and compare results of the liberalization efforts to anchor the above arguments, focusing specifically on Germany. Following an assessment of market developments, the paper attempts to identify key regulatory and legal impediments to broader competition, together with recommended actions to improve competition and innovation in these markets.
Price regulation has always been a pillar and decisive factor in the field of postal regulation. However, the year 2011 has been a milestone and an incisive year in the area of price regulation in the German postal market. First of all, in the ex-ante field a recent price cap decision has been issued setting the corner stones and paving the future way for the price cap framework while taking into account possible developments in volumes and sales resulting from electronic competition. Secondly, two major decisions have been taken by applying ex-post control mechanisms in the area of anti-competitive pricing. Those rulings raised a variety of questions of regulatory interest, inter alia on the scope of the non-discrimination rule and predatory pricing in the light of the existing legislative framework and the possible necessity for an adjustment of the regulatory provisions in place. All decisions by the regulatory authority have attracted quite some attention among the market players and lead to intense discussions. Against this background it seems worthwhile to elaborate in some more detail on the applied regulatory practice and to undertake some reflections about price regulation in the light of changing mail volumes and substitution effects resulting from electronic competition.

In part one this paper examines the most recent ex-ante decision taken in the field of price regulation. Therefore, it deals with the basic set up of the current price cap regime and its decisive parameters. At the same time it takes into account the changing market environment as well as the “state of art” concerning competition on the postal market and elaborates on the modifications and specifications undertaken within the current decision. In this respect it is an interesting observation that at least for now mail volumes are more or less at a stable level in Germany (in contrast to other countries) although the substitution effects caused by electronic competition already take place in practice. Against this background and in the light that “prediction is very difficult, especially about the future” (Niels Bohr), the paper is reflecting the recent price cap decision taking into account the possible development of volumes in the postal market including the possible impact of declining mail volumes from electronic competition with regard to a future price cap regulation regime.

Part two of this paper assesses in more detail the most recent regulatory ex-post decisions concerning the pricing by the incumbent operator. The first ruling in the capacity of this so called special control of anti-competitive behaviour was taken on 14th June 2011 in the “First Mail” case, where the conclusion was reached that the undertaking “First Mail, a 100% subsidiary of the incumbent operator, infringed the rules on rates regulation enshrined in the Postal Act by offering significant lower tariffs in comparison to the mother company in certain regional areas of the country facing intense competition in the mail market. All in all the decision stated an infringement of the non-discrimination rule and affirmed the allegation of predatory pricing aiming to squeeze out competitors instructing the entity to adapt its rates accordingly. While the first two instances upheld the decision taken the operator decided to discontinue its operations.

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The second ex-post based pricing ruling of 15th September 2010 addressed within this part of the paper is dealing with rebates for incidental services granted by the incumbent operator. Whereas competitors argued that the increased rebates would lead to the exclusion of alternative “end-to-end” delivery networks leading to a foreclosure of competition, the regulatory authority came to the conclusion that there was no infringement of the non-discrimination rule as the rebates for incidental services were offered to all customers of those services including the competitors. Against this background the paper is evaluating this decision thoroughly addressing in especially the question whether the current legislative framework on price regulation, within the ruling was taken, should be subject to an adjustment within a possible legislative reform taking into account the experiences from the telecommunications sector.

Finally, in the light of the most recent developments on the European level it seems worthwhile to shed some light on the evolution of price regulation and cost allocation issues addressed within the respective working group of the recently in 2010 established European Regulators Group for Post (ERGP). Against this background the paper is concluding with an assessment of the interrelation and the impact of the work undertaken on the European level with regard to the respective decisions undertaken on the national level.