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**Article**

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Weekly Report

**Provided in Cooperation with:**

German Institute for Economic Research (DIW Berlin)

*Suggested Citation:* Heitzler, Sven (2008) : Only Little Justification for Regulation in the Postal Sector, Weekly Report, ISSN 1860-3343, Deutsches Institut für Wirtschaftsforschung (DIW), Berlin, Vol. 4, Iss. 9, pp. 58-61

This Version is available at:

<https://hdl.handle.net/10419/151032>

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# Weekly Report

## Only little justification for regulation in the postal sector

*European postal markets are to be completely liberalized by the end of 2012 at the latest. At the same time national regulatory frameworks are being adapted to the new requirements. The extent to which the present monopoly suppliers will in future (continue to) be obliged to grant their competitors access to their network is also under discussion. In this respect the postal sector is often compared to the telecoms sector. However, the differences between the two industries are so great that regulation of telecommunications cannot be transferred to the mail sector. Obligations to provide network access and regulations on final prices in particular can scarcely be justified in the mail sector. The regulatory strategy that should therefore be pursued during the liberalization process is one that places the minimal requirements necessary to create the best possible conditions for effective competition, for example access to address lists and PO boxes.*

In Europe on 1 January 2008, Great Britain, Finland, Sweden and Germany fully opened up their postal markets to competition. The most recent European Postal Directive also requires all other Member States to fully liberalize their markets by the end of 2010 (for some countries by the end of 2012).<sup>1</sup> This is the context within which further development of the respective national regulatory frameworks for the postal sector is presently being discussed. One of the key issues is whether the present monopoly suppliers will be mandated to grant competitors access to their distribution networks once the markets are fully open and be obliged to transport and deliver their competitors' mail.

### **Vast differences between the mail and telecom industry**

In the discussion about optimal structuring of market conditions in the mail sector, regulation of the telecommunications industry is often cited as a comparison. In both sectors there is a link due to their closely interlocked key roles in the information society and the liberalization of these network industries. Moreover, the former monopolists still possess extensive market shares. However, there are vast differences in the central sectors that severely limit direct comparisons.

<sup>1</sup> Directive 2008/6/EC of the European Parliament and the advice of 20 February 2008 on amendment of the Directive 97/67/EC regarding the accomplishment of the single market for postal services in the Community. Official Journal of the European Union L 52/3, Brussels, 27.2.2008.

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**JEL Classification:**  
L51, L13, D43

**Keywords:**  
Postal economics,  
Postal regulation,  
Telecommunications regulation,  
Transferability

Telecommunications networks, at least fixed land-line networks, are physically permanent, interconnected infrastructures like those found in electricity, gas and water distribution networks. While the construction of these infrastructures is associated with very high, non-reversible (so-called sunk) initial investment, the costs of using the networks are relatively low. With telecommunications networks it is mainly connection of individual households over the so-called last mile that results in sunk costs when new infrastructures are constructed. actual usage. Basic charges to cover connection costs and related long-term contracts are generally not the norm.

### **The potential for competition in postal and telecommunications markets**

By contrast postal networks are logical networks with nodes formed by mailboxes or post offices, the sorting centers and the mailboxes of the addressees. The sole link in these nodes is a process chain that comprises the activities of collection, sorting, conveyance and distribution of mail via a wide variety of transportation means (bicycles, road, railroad and aircargo). The cost structure of these networks is vastly different than that of the telecommunications sector.

Although the last mile in the mail sector is responsible for the bulk of mail delivery costs from the delivery office (ZSP) to the addressees, this does not involve high sunk investment. Delivery to the addressee is based largely on work input and therefore mainly generates variable costs. The fact that the share of variable costs in a postal network is relatively high as compared to the total costs becomes obvious when one considers that, even when highly automated sorting centers are installed, labor accounts for about three quarters of the costs. If mail is processed manually (as it usually is in developing countries and emerging markets), then the percentage of (variable) labor costs is considerably higher.

Further differences between the postal and telecommunications networks result from the shelf life of the mail and the resulting real time requirements as well as the properties of the networks with regard to congestion. Unlike telecommunications connections, it is possible to store mail over a short period and additional network capacity (transport capacity) can quickly be supplied.

The different characteristics of telecommunications networks and postal networks are also reflected in the tariffs for use of services: While a monthly basic charge for connection to the network combined with

different tariffs for usage is standard in the telecommunications sector, postal services are priced almost exclusively on the basis of

The different cost structures in both sectors do not just give rise to different tariffs; their main impact is the stark contrast in the terms under which competition in both sectors can develop.

The investment needed for entry to the telecommunications sector market leads to an entry barrier, such that it is hard for competition to emerge. There is also the fact that the duplication of existing networks only makes sense, including economic sense, if there either capacity constraints exist or if new networks have new features such as higher transmission capacity.

By contrast there are few barriers to entering the postal service market. The high percentage of variable costs means that it is relatively easy to enter and exit markets and networks can easily be replicated. This also applies to areas where no single telecommunications supplier has previously been prepared to invest in appropriate network construction or development. The German Federal Network Agency confirms this when it states that, parallel to liberalization of the market, there has essentially been significant development of end-to-end-competition (from collection to delivery) and complete area coverage with a “remarkably high number of license holders in the new Federal States” and that “the network coverage achieved there proves that provision by alternative suppliers is a given, even in structurally weak areas.”<sup>2</sup> As well as the cooperation of regional suppliers, contractors in the parcel segment already have a comprehensive network of branch offices that can easily be used for sending letters.<sup>3</sup> In addition, since the Deutsche Post AG lost its exclusive license on 1.1.2008, the regulatory authority is expecting further expansion of the competitors’ market shares as it was already observable in the years 1999 to 2006.<sup>4</sup>

The market developments observed lead to the assumption that there is considerable potential for competition in postal markets everywhere. Moreover, to a large extent courier and express service providers or electronic communication media, such as telefax, e-mail or SMS for example, are able to provide substitutes for postal services.

<sup>2</sup> German Federal Network Agency: Lage und Entwicklung auf dem Gebiet des Postwesens. Tätigkeitsbericht 2006/2007, 46.

<sup>3</sup> For example, Hermes, cf. German Federal Network Agency, l.c., 60.

<sup>4</sup> In aggregate the number of people employed in the sector over this period easily rose from 194,838 to 196,266. Meanwhile the rise in people employed by competitors more than compensated for the downsizing at Deutsche Post AG. German Federal Network Agency, l.c., 41.

Therefore the considerable differences between postal and telecommunications markets lead to different regulatory requirements. Within the European regulatory framework regulation is only justified, if the following three criteria are all simultaneously met:

- High and non-transitory entry barriers exist,
- there is no tendency towards effective competition within a defined time horizon, and
- it must be ensured that the application of competition law alone is insufficient to address the barriers to competition.

### Regulation in telecommunications

Telecommunication regulation is based fundamentally on the consideration that there is no tendency towards effective competition because of the barriers to market entry and that competition cannot be achieved without regulation. The key part of any network infrastructure regulation is the opening of existing networks to possible competitors. If the latter can use the existing infrastructures, then there are significantly less barriers to market entry and competition will result in better use of existing infrastructures.

Although this consideration appears basically plausible, there are a number of difficulties to bear in mind: from a conceptual aspect the access regulations to existing networks will always reduce the value of new networks and investments. The extent to which existing networks are accessible might make it not worthwhile for competitors to construct their own infrastructures.

Access regulations face the problem that although they can guarantee effective use of the existing networks, in fact they not only reinforce the monopoly position of the present suppliers but also reduce incentives to invest in new infrastructures.

Experience from the telecommunications sector also shows that the implementation of access regulations poses a number of practical problems. If access prices are calculated on the basis of the total investment costs of creating the network (total cost), they tend to be too high as competitors must pay more than the costs they induce through use of the network. If the costs of effective service provisioning provide the basis for access prices, the regulated company faces the risk that it can no longer cover its total costs. This may happen, for example, when the network has been expanded over time because of increasing demand which in turn might result in higher operating costs than with a new installation.

The same also applies when costs gradually decline because of technological progress.

Finally, access regulations usually require additional interventions. As well as quality definitions and regulations that guarantee equal treatment of all companies active in the market, the relation between access prices and retail prices must also be taken into account. In order to ensure effective market entry, regulated companies for instance must be prevented from setting their retail prices so low that they are below the access prices. The resulting margin squeeze would mean that efficient competitors would no longer have any incentive to enter the market and the regulated company could secure its market-dominating position.

Overall this shows that, although access regulations can achieve efficient use of existing networks, they also involve relatively high regulatory costs.

### Access obligations in the postal sector

The basic options concerning postal networks are access to the outbound mail centers (BZA), the inbound letter mail centers (BZE), the delivery offices (ZSP), the PO boxes and delivery information. Regulations can only be justified where access to end customers is limited—similar to that in the telecommunications sector. This applies to access to PO boxes and address lists, without which services such as redirecting mail are not possible and delivery of official or business mail to all receivers cannot be guaranteed. Access regulations to the mail centers and delivery points are justified only in very exceptional cases (such as in especially sparsely populated regions and areas which are hard to reach) because investment costs for postal networks are neither sunk nor so high that they prevent market entry.<sup>5</sup> The advantages and disadvantages must certainly be balanced carefully and the question has to be answered, whether the actual and potential competition is sufficiently intense to produce effective market outcomes. The competition from companies that offer relatively close substitutes through other delivery services is of prime importance here.<sup>6</sup>

In Great Britain and the USA for example network access and prices are regulated. The outcome of this has been that, although competitors have entered the market, market entry has been principally at a local level. There do not appear to be comprehensive offers from competitors. On the other hand, the large

<sup>5</sup> Cf. De Bijl, P., Van Damme, E. E. C., Larouche, P.: *Light is Right. Competition and access Regulation in an Open Postal Sector*. Tilburg Lawand Economics Center (TILEC), Tilburg University, NL, 2005.

<sup>6</sup> Inclusive suppliers of hybrid post, i.e. post that has been sent digitally and is printed and dispatched at the destination center.

amount of competition in the non-regulated courier, express and parcel markets and the strong purchasing power of the large customers argue against such regulation or, moreover, that it should be phased out.<sup>7</sup>

In Germany, access regulation to the distribution centers (BZA and BZE) is based on § 28 of the postal act on the one hand which obliges the company with a strong market position to offer [part performance], on the other hand it is based on a decision of the Federal Cartel Office that discrimination between competitors and large customers is forbidden on the basis of the general competition law.<sup>8</sup>

There is high competitive pressure in the postal industry, especially in the business customer segment. Competition law and the ex-post supervision of end prices should be sufficient here with no need for sector-specific regulation. Possible regulations on final prices to protect the consumers should therefore be restricted to the prices of individual items of mail or even only be subject to ex-post abuse control.

Examples of such reluctance in the field of price regulation are to be found in Germany where, price controls apply only to mail posted in amounts of up to 50 items. It is also to be found in Sweden where only the price of individual letter mail items is still directly regulated. In Finland there is no longer any ex-ante control; prices for postal products are subject only to the requirement that they have to be “fair and cost-effective”, backed up subsequently only by ex-post control.

## Conclusion

Postal markets are clearly different from telecommunications markets and have considerable competition potential. In parallel with the full market opening, a minimalist regulatory approach should be pursued which confines itself to the same obligations to all suppliers (symmetrical regulation) with regard to access to PO Box facilities and delivery information, e.g. redirection databases, and minimal price control. Apart from this, the competition authority should put in place effective abuse controls in order to create symmetrical terms for all market participants as far as it is possible and to create the best possible conditions for effective competition.

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ISSN 1860-3343  
Price: Euro 10.–  
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<sup>7</sup> Across the EU 87.5 percent of the post from is dispatched by companies, only 12.5 percent by private individuals and microenterprises cf. wik-Consult: Main Developments in the Postal Sector (2004–2006). Study for the European Commission, DG Single market and services, 2006, 198.

<sup>8</sup> German Federal Cartel Office Decision B9-55/03 of 11.2.2005 after complaints from competitors because they were not granted the same conditions as bulk mailers.