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Weekly Report

Maximizing the Gains from Postal Service Market Liberalization

The upcoming full liberalization of postal service markets under the European regulatory framework offers the chance to further increase regulatory efficiency. Obstacles to competition and barriers to market entry should be systematically removed, and existing obligations for all companies reduced as much as possible. In this connection, universal service obligations should be modernized and flexibly designed. Competitively neutral financing for universal service burdens should also be put in place. Moreover, national or company-specific protectionism should be avoided to boost fair competition and the long-term development of the market.

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The European postal service market is located at the intersection of the communications, transportation, logistics, and advertising industries. Its crucial importance makes it an indispensable element of the Lisbon strategy, which aims to promote innovation, economic development, employment, and competitiveness. Across Europe, the postal sector currently generates annual revenues of about 88 billion euros (about 0.9 percent of the EU's GDP) and accounts for around five million jobs. In 2005, the EU's incumbent postal operators alone generated revenues of around 58 billion euros (0.53 percent of the EU's GDP) and employed 0.57 percent of the entire workforce.¹

The postal service market consists of the courier, express, and parcel service markets (CEP), as well as the letter mail services market, which is the largest in terms of volume and revenues. The letter mail market is itself composed of three areas: correspondence mail (letters), transactional mail (for example, invoices or account statements) and direct mail. Noteworthy in this regard is that around 85 percent of all postal items are sent by companies. The remaining proportion of individual shipments sent by private households (or microbusinesses) is relatively small.

Competition in the European letter mail markets still limited

Although the liberalization of European postal markets—which have traditionally been dominated by government monopolies—has been on the EU's agenda since

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¹ Lumio, M., S. Fickinger: Postal Services in Europe, Eurostat Data in Focus 12/2007

1992, Europe's letter mail markets (in contrast to the CEP markets) are still governed by extensive regulation.²

Currently, market access regulations and letter delivery monopolies are still important elements of Europe's regulatory regime.³ In addition, while the incumbent companies have numerous advantages (such as sales tax exemptions), they are also subject to requirements regarding: *i*) pricing (e.g. nationally uniform tariffs or price increase limits); *ii*) the provisioning of universal service (see box); as well as *iii*) granting mandatory network access to competitors.

The most recent European postal services directive requires European countries that have been gradually liberalizing their markets to entirely open the remaining legal monopolies to competition by the end of 2010 (some remaining countries until 2012). Going beyond the requirements of the European guidelines, Finland, Germany, Sweden, and the UK have already abolished the legal monopolies and opened their markets to competition.

Existing asymmetries produced by tax advantages—such as an exemption from sales tax for universal service providers, universal services, or reserved services—are also an obstacle to fair competition. For this reason, the European Commission is studying such tax privileges. She considers them as potential instances of government subsidy that create unfair competition according to Article 86 of the EC Treaty, as alternative competitively neutral methods of financing the universal service are feasible.⁴

Alongside various liberalization and re-regulation strategies, differences among the former government companies in terms of their autonomy and level of privatization can also be observed. Government enterprises that are organized like private-sector companies or which have been privatized, or whose markets were liberalized early, differ significantly in terms of:

- the type and extent of competitive pressure they face;
- their level of financial independence and responsibility; as well as

- the scope and type of decision-making freedom enjoyed by management.

Frequently, these companies are better prepared to cope with required structural adjustments, such as the partial outsourcing of delivery or branch-office networks, or the diversification of business activities. It is also often easier for these companies to overcome political or union resistance to structural changes. As a result, it can be expected that such companies will be relatively successful once the liberalization of domestic postal markets is complete.⁵

In liberalized countries the development of a competitive market is also more advanced because competitors may already have their own delivery networks or have signed cooperative agreements with other (regional) providers.⁶ Competitors are therefore not dependent on the delivery network and transport services of the established provider. This enables them to compete profitably or at least with expectations of profit across the entire supply chain, from collection to delivery (end-to-end), particularly in more densely populated areas.⁷

Because competitors do usually enter the market without a comprehensive delivery network, their services and cost structures differ. The lack of their own delivery network also makes the household and microbusiness segment less attractive for new postal companies. This is the primary reason for maintaining universal service regulations, even if it protects not only households and microbusinesses from possible negative consequences regarding service quality.

In general, the development of competition has been slower than expected so far. The former public monopolists still enjoy a market share above 90 percent within the EU member countries. In addition, demand for postal services has fallen recently due to the overall economic climate, and considerable demand shifts have been witnessed.⁸

² EU: Green Paper on the Development of the Single Market for Postal Services, Commission of the European Communities, COM/91/476, Brussels 1992.

³ Consisting of the Directives COM 1997/67/EC, 2002/19/EG and 2008/6/EC.

⁴ On July 29, 2009, the German Federal Cartel Office referred a complaint by the Federal Association of German Postal Service Providers (Bd KEP) to the European Commission. Alternatives for financing universal service include an industry fund or the tendering of a government contract.

⁵ Ayub, M. A., S. O. Hegstad: Public Industrial Enterprises: Determinants of Performance, 2009.

⁶ In Finland, companies that want to enter the market are also required by licensing conditions to provide universal service. This has effectively created a barrier to market access. The result is basically no growth in competition whatsoever thus far.

⁷ In Britain, so-called *access prices* are regulated and relatively low, therefore access is preferred to end-to-end competition.

⁸ Demand shifts are taking place on the one hand to other media due to increasing access to information and communications technologies (for example, e-mail, text messages, and webpages) as well as competing advertising channels (print, radio and online media), and, on the other hand, to cheaper mail categories (with longer delivery times or lower weights achieved with lighter paper or two-sided printing).

Universal Service Obligations—What Are They?

Starting with the first Postal Services Directive in 1997, one of the main goals during the creation of a European-wide regulatory regime has been to guarantee a minimum scope and quality of service under reasonable conditions.

The term “universal service” involves minimum requirements for postal services with respect to access, quality, and price. Member states are obligated to ensure that they provide reliable and reasonably priced delivery services for mail weighing up to two kilograms and packages weighing up to 20 kilograms (including registered and insured mail) both nationally and across the EU. The regulations that define the minimum service level include rules for maximum delivery transit times and minimum requirements for access to postal services.

Within the EU, 85 percent of all (cross-border) items sent must arrive at their destinations within three days and 97 percent must arrive within five. National delivery times are defined by national regulations in the individual member states (80 to 97 percent of domestic letter mail delivered the day after the item is sent).

Finally, to ensure the services are universal, mail collection and delivery must occur at least five

days a week across the country. Regarding collection points, the obligations also entail either minimum numbers for certain regions or maximum distances. Delivery must also occur at the recipient’s premises or at another “suitable facility”. The member states have significant freedom in defining the concrete form of the regulations so they can reasonably accommodate specific circumstances in their countries. Exceptions are also allowed for particularly difficult conditions (in remote or thinly populated areas such as the mountains or on islands, for example).

To ensure universal service does not distort competition, it can be flexibly implemented: universal service does not have to be provided exclusively by one company, but can also be provided by several companies in the market. Against the backdrop of a downward trend in mail volume, falling revenues among former government monopolies, and the abolishment of monopoly rights (“reserved areas”), the third Postal Services Directive in 2008 revised the financing rules for universal service. If universal service creates a significant financial burden for its provider, as a remedy the government may grant subsidies, or market participants may be required to contribute to a so-called “universal service fund”.

The resulting decrease in mail volume is leading to significant drops in profit or even losses for the established mail service providers. As a consequence, many companies are under force to reduce their staffs significantly. For example, TNT in the Netherlands is planning to reduce the number of employees from 23,000 to 12,000.

Consolidation processes are also underway as a result of the stagnation or shrinking of letter mail markets. In Scandinavia, for example, a merger between the two former monopolies Posten AB (Sweden) and Post Danmark (Denmark) is in full swing. In addition, Swiss Post International (SPI) has announced that it will consolidate SPI Denmark and SPI Sweden to form a new company, SPI Scandinavia.

Finally, additional protectionist tendencies that aim to delay or limit the introduction of competition can be identified in countries where the government

postal companies are very closely linked to the political sphere (for example, in France and Greece).

Labor market regulations might also limit competition

Considering the large number of employees in the postal sector, labor market regulations are another important political issue besides product market regulation. Besides rigid labor market regulations which might restrict possible efficiency gains by delaying the introduction of modern, labor-saving technologies or the reduction of overcapacities, a prominent example for labor market regulation inhibiting competition is a high sector-specific minimum wage.

A basic realization that must be accepted is that the transition to a fully competitive postal service market could lead to the decline of established com-

panies, temporarily increasing unemployment levels and reducing real wages.⁹

From an economic perspective, excepting companies from competitive pressure cannot be justified even when high numbers of employees are involved. In the long run, the market can be expected to develop in a more desirable fashion when it is allowed to adjust naturally to competitive forces. Such protectionism therefore is to be viewed as detrimental.¹⁰ Labor market regulations can have severely negative repercussions on product markets.¹¹

In Germany, the opening of the market on January 1, 2008, was accompanied by the introduction of minimum wages between 8.00 and 9.80 euros for workers in the postal sector (depending on position and region). There is uncertainty about the legal validity of this minimum wage. This wage regulation has already been judged unlawful on appeal, yet the Federal Ministry of Labor and Social Affairs is still backing the regulation, asserting that the minimum wages are legally valid. The next instance decision by the Federal Administration Court (Bundesverwaltungsgericht) is expected not before the end of 2009.

Since the introduction of the minimum wage, 39 of 90 regional PIN Group companies, the parent company PIN AG itself, and some other postal service providers have all filed for bankruptcy. By contrast, TNT, the second main competitor to Deutsche Post (Germany's national postal service), has optimized its existing network in terms of delivery speed and, thanks to a new strategic partnership, has expanded its coverage area to 40 percent of all households. Together with its delivery partners, TNT now reaches almost 93 percent of all households in Germany, without the need to rely on Deutsche Post's delivery services. According to newspaper reports, TNT is also considering offering next-day delivery services. For its part, Deutsche Post increased its market share in Germany from 88.7 to 89.3 percent between 2007 and 2008.¹²

Systematic reform promotes innovation, competitiveness, and lowers prices

The complete opening of the market offers numerous potential benefits, including lower prices as a result of increased competition as well as the introduction of innovative services that better meet the needs of customers and mail recipients (e.g., services that combine classic mail delivery with modern information and communications technologies). In addition, the potential exists to increase the total size of the market, employment, productivity, and flexibility, as well as overall market competitiveness.

Yet this can only be achieved if general regulatory conditions are aligned with the above goals. Otherwise, there is a risk that other barriers to market access will replace legal monopolies during the reform process and prevent the future reallocation of resources.¹³ Faulty regulations result in the squandering of resources, as they prevent the implementation of some options for increased efficiency, and, in turn, the development of efficient technologies and market structures. By contrast, extensive deregulation that leaves a reasonable amount of regulation in place can help to improve both static and dynamic efficiency.

Because of their specific characteristics, postal service markets can manage with a minimum level of "classical" network industry regulation.¹⁴ The disadvantages for private households and microbusinesses that could potentially result from the opening of the market could be minimized by an appropriate modification of universal service requirements and the ex-post supervision by regulatory agencies—while still accommodating structural change and ensuring competitively neutral financing for universal service.¹⁵

If postal service providers operate according to free-market principles, the costs to maintain offices and delivery in less densely populated areas or those with difficult geographical characteristics are still disproportionately high from an economic perspective—especially given that 85 percent of all mail is sent by businesses. (This geographical problem is not unique to mail services, however, and

⁹ See Blanchard, O., F. Giavazzi: Macroeconomic Effects of Regulation and Deregulation in Goods and Labor Markets. *Quarterly Journal of Economics*, August 2003.

¹⁰ See Cave, M.: How Far Can Liberalization of Postal Markets Go? CRI Proceedings 29, Promoting Effective Competition in UK Postal Services, Chapter 8, University of Bath 2002, 75-88.

¹¹ Koedijk, K., J. Kremers, P. David, L.-H. Röller: Market Opening, Regulation, and Growth in Europe. *Economic Policy* 11(23), October 1996, 445-467.

¹² See German Federal Network Agency: Annual Report 2008, Bonn 2009.

¹³ See also Loayza, N. V., A. M. Oviedo, L. Servén: Regulation and Macroeconomic Performance. The World Bank and University of Maryland, 2004.

¹⁴ Heitzler, S.: Traditional Regulatory Approaches, and the Postal Service Market. *Competition and Regulation in Network Industries* 10 (1), 2008, 77-105.

¹⁵ See Finger, M., I. Alyanak, P. Rossel: The Universal Postal Service in the Communications Era: Adapting to Changing Markets and Customer Behavior. Report, EPFL Lausanne, 2005.

is also faced by pharmacies and banks.) Private sector companies, however, can more easily implement alternative solutions such as mobile post offices or *hybrid* delivery.¹⁶ Employment adjustments are also easier to make when labor market regulations are not too rigid.

Similar to the successes achieved in the telecommunications sector, logical and consistent reform can be expected to lead towards effective competition and result in an increase in productivity, an improvement in service quality, and lower prices.¹⁷

Conclusion

While it may not be realistic at current economic conditions to expect the rapid development of a fully competitive marketplace following complete liberalization and regulatory reform, the liberalization of European mail services should nevertheless be systematically pursued because of its extraordinary strategic importance.

The implementation of the European regulatory framework offers significant opportunities, if market intervention is aimed at supporting the growth of competition and adaptability of existing companies, and if no new barriers to competition are created.

National laws should be written to ensure the promotion of open and fair competition. This means that symmetric conditions for all market participants should be set to entail as few restrictions as possible and optimally suit regional conditions. Regulation should be limited as much as possible to protecting consumers and microbusinesses.

Alongside the elimination of privileges for individual companies (i.e., privileges for established companies as well as measures for the targeted promotion of market access), universal service should be modernized and limited to single-item mail while allowing flexibility for attaining other objectives. In order to maximize the success of regulatory measures, it is necessary to make their economic advantages, goals and the schedule for their implementation as transparent as possible.

Regard should also be given to *intermodal* competition from electronic media. A definition of universal service that takes into account modern ICT technologies should consider changes in sender demand as well as recipients' needs.

Protectionist tendencies such as excessively stringent licensing conditions, the delay of planned liberalization measures, or creation of obstacles to market access—for example, with particularly strict labor market regulations—hurt the development of the market as a whole and, in the long term, all market participants.

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¹⁶ With so-called hybrid delivery, the recipient first receives a scan of the sealed envelope sent electronically and then decides whether the item should be delivered, opened, scanned and sent digitally, archived or thrown away. See Buser, M., C. Jaag, U. Trinkner: Economics of Post Office Networks: Strategic Issues and the Impact on Mail Demand. Rutgers CRRI, 2008.

¹⁷ See, e.g., Boylaud, O., G. Nicoletti: Regulation, Market Structure and Performance in Telecommunications, 2000.

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