

Cost and Financing of the USO: EU experiences and conclusions for the Polish postal market

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7th Conference “Market of Postal Services in Poland 2011”
Warsaw, 21 September 2011

Who is WIK-Consult?

- WIK ('Scientific Institute for Infrastructure and Communication Services')
 - Independent research institute, owned by the German government
 - ~ 40 consultants/researchers
 - More than 25 years of experience with economic regulation and sector policies
 - Telecommunications, postal and energy markets
- WIK-Consult is a 100% subsidiary of WIK
 - Consultancy specialised in regulated industries, founded in 2001
 - ~ 60% of revenue from customers outside Germany

Contents of Presentation

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- In Poland reserved area still main source for financing the universal service obligation (USO)
- Full opening of Polish letter market foreseen in 2013 (postal legislation is still pending)
- Third Postal Directive requires full market opening and set strict rules for external funding
 - Precondition for external funding of USO in fully liberalized postal markets: Calculation of the USO net cost
- Definition of the USO net cost (Third Postal Directive, Annex I):

“The net cost of universal service obligations is to be calculated, as the difference between the net cost for a designated universal service provider of operating with the universal service obligations and the same postal service provider operating without the universal service obligations.”

Introduction

Third Postal Directive (Art. 7 and Annex 1)

Purpose	<ul style="list-style-type: none">• Precondition for external funding• Article 7 (3):“Where a Member State determines that the USO [...] entail a net cost, and represent an unfair financial burden on the USP [...]”
Services or service elements considered	<ul style="list-style-type: none">• Elements of services provided at loss or under cost conditions falling outside normal commercial standards• Specific users or groups of users served at loss or ... (revenues not cost-covering due to social, uniform, or affordable tariffs)• Calculation made separately per aspect (element or user group) of USO under avoidance of double counting
Cost concept	<ul style="list-style-type: none">• Avoided cost
Reference scenario	<ul style="list-style-type: none">• Same postal operator without USO
Cost & revenues considered	<ul style="list-style-type: none">• Assessment of “net cost” effects (including a reasonable profit)• Consideration of<ul style="list-style-type: none">• benefits (“intangible and market benefits“) to the USP• incentives for cost efficiency
Methodology	<ul style="list-style-type: none">• Shall be verified by NRA (USP shall cooperate)

Practical Experiences in Europe

Overview of Surveyed Approaches

- Limited experience with calculation of USO net cost in the EU
- Following examples are presented (including non-EU countries)
 - Denmark / Copenhagen Economics commissioned by Danish Chamber of Commerce (2007)
 - France / La Poste (universal service provider)
 - Norway / Norway Post (universal service provider)
 - Switzerland / WIK-Consult/BDO commissioned by Swiss regulator PostReg

Practical Experiences in Europe

Denmark / Copenhagen Economics (2007)

Purpose	<ul style="list-style-type: none">• Inform postal policy (no legal mandate)• Model prepared for Danish Chamber of Commerce
Services or service elements considered	<ul style="list-style-type: none">• Nationwide delivery• 6-day-delivery• Routing time targets, etc.
Cost concept	<ul style="list-style-type: none">• Avoided costs of the service elements
Reference scenario	<ul style="list-style-type: none">• Alternative business model of Post Danmark (absent the USO)<ul style="list-style-type: none">- Delivery frequency down from 6 to 5 days per week- Free services for blind discontinued
Cost & revenues considered	<ul style="list-style-type: none">• Estimated cost and revenues per service element• Not based on accounting data
Result (FY 2005)	<ul style="list-style-type: none">• DKK 150m – approx. 1.5% of operating expenses

Practical Experiences in Europe

France / La Poste

Purpose	<ul style="list-style-type: none"> • Determination of costs of "réseau grand public" (postal outlets) resulting from La Poste's regional planning and development mission • La Poste benefited from an 85% reduction in local taxes (2010)
Services or service elements considered	<ul style="list-style-type: none"> • Retail network (postal outlets) • Separate analysis for "postal USO" and "regional planning and development mission"
Cost concept	<ul style="list-style-type: none"> • Avoided costs
Reference scenario	<ul style="list-style-type: none"> • Retail network of a profit-maximizing company ("commercial network") with the same service portfolio (postal and financial services)
Cost & revenues considered	<ul style="list-style-type: none"> • Break down into additional costs attributable to the accessibility obligation (part of USO) and additional costs attributable to regional planning and development mission • Estimation based on cost & revenue accounting data and econometric modeling
Result	<ul style="list-style-type: none"> • Not published

Practical Experiences in Europe

Norway / Norway Post

Purpose	<ul style="list-style-type: none"> • Determine subsidies from state budget (“Government procurements”)
Services or service elements considered	<ul style="list-style-type: none"> • Frequency of delivery (by area) • Retail network • Free services to the blind • Non-uniform tariff / surcharge to Spitsbergen (remote island)
Cost concept	<ul style="list-style-type: none"> • Avoided costs of service elements
Reference scenario	<ul style="list-style-type: none"> • “Commercial business model” determined by Norway Post <ul style="list-style-type: none"> - Delivery frequency down to 5 days for 15 % of population and down to 2 days for 5 % of population - “Mobile post offices” reduced by half - Introduce charges for services for the blind - Surcharge for mail to and from Spitsbergen
Cost & revenues considered	<ul style="list-style-type: none"> • Revenue effects are considered to be negligible • Based on estimated volume and cost development of the next FY
Result (2010)	<ul style="list-style-type: none"> • NOK 497m / 2.4 % of operating expenses • Increasing trend because of declining mail volume

Practical Experiences in Europe

Switzerland / PostReg

Purpose	<ul style="list-style-type: none"> • Legislation requires report of “infrastructure contribution” • No external funding
Services or service elements considered	<ul style="list-style-type: none"> • Retail network (postal outlets)
Cost concept	<ul style="list-style-type: none"> • Avoided costs
Reference scenario	<ul style="list-style-type: none"> • Commercial retail network: Reduced number of postal outlets from 2,313 (1,955 post offices / 358 agencies) to 1,700 (700 post offices / 1,000 agencies) • Based on an international benchmark (national postal operators) combined with a national benchmark (Swiss industries operating retail networks: food stores, petrol stations and banks)
Cost & revenues considered	<ul style="list-style-type: none"> • Revenue effects are not considered (assuming constant demand) • „infrastructure contribution“ corresponds to the fixed cost of excess postal outlets operated by Swiss Post personnel • Based on historical cost data
Result (2010)	<ul style="list-style-type: none"> • ~ CHF 198m / 3 % of operating expenses

Practical Experiences in Europe

Conclusions

- Consensus in recent approaches: Profitability cost approach (theoretically developed by John C. Panzar and Helmuth Crèmer)
 - Consistent with key requirements of Third Postal Directive (Annex I)
 - Calculate change in USP's profits due to relaxing the USO
 - Key question: How would the USP change service levels if the USO was relaxed?
 - Most important areas for service degradations (without a USO)
 1. Reduced frequency of delivery
 2. Post office closures and conversion to contracted agencies
 3. Remove “social prices”, e.g. free service for the blind
 - Open questions:
 - How to quantify intangible and market benefits to the universal service provider?
- How to determine whether calculated USO net cost are an unfair burden?

Conclusions for the Polish Postal Market

- Polish postal market characterized by
 - Low mail volume per inhabitant (around 52 letters, stagnating)
 - Emerging competition in the national letter market (InPost)
 - Substantial competition in the markets for parcel & express services and the distribution of unaddressed advertising
 - Commercialisation and modernisation of Poczta Polska lagging behind
- Under current conditions external funding of the USO may be necessary after full market opening → necessity to determine the USO net cost
- Determining net costs of the USO requires the development of a reference scenario

Conclusions for the Polish Postal Market

- The reference case should
 - refer to services and service elements required by the USO
 - reflect the business strategy of the universal service provider
 - be a realisable and a credible commercial alternative
 - take the demand side and further benefits into account
- The postal service provider need not necessarily discontinue services. Adapting service elements may be the more suitable solution
- Pending postal legislation offers opportunity to think about
 - Relaxed USO requirements (e.g. uniform tariffs only for single-piece items, exemptions from 5-day delivery in rural areas)
 - Regulatory measures to promote cost efficiency in universal service provision (e.g. price cap regulation, procurement of US elements)



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