

Do we need ex ante price regulation in a liberalised postal market?

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Postal markets between monopoly and competition

Introduction Background

- No common approach for scope of ex ante price regulation in EU

| Services subject to ex ante price control | Member States |
|--|--------------------------|
| Reserved services | e. g. AT, ES, HU, IE, LU |
| Universal service | e. g. IT, LV, MT, SI, SK |
| No ex ante price regulation | e. g. FI, PL |

- Current postal law in Germany after full market opening (2008):
 - Ex ante price regulation for single piece mail only
 - No ex ante control for bulk mail (> 50 pieces)

Introduction

Purpose of the Study

- Which letter services should be subject to ex ante price regulation after full liberalisation?
 - Avoid overly excessive regulation where it is not appropriate
 - Protect customers and competition where necessary
- Evaluation of current German postal law
- Methodology
 - EU market definition, market analysis, and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services
 - Analysis for situation **after full market opening**
 - Based on our expectations for future market development
 - Analysis influenced by current situation: ex ante regulation, especially third party access and monopoly for some services

Introduction

EC Framework for Markets for Electronic Communication

- i. Market definition
- ii. Application of 3 criteria
- iii. Is there significant market power?
- iv. Choice of ex ante remedies



1. High and non-transitory entry barriers

↓ If Yes:

2. No tendency towards effective competition within the relevant time horizon

↓ If Yes:

3. Application of competition law alone would not adequately address the market failures concerned

Contents of Presentation

- Market analysis: German letter markets
 - A) Market definition
 - B) Three criteria
 - C) Significant market power?
 - D) Choice of remedies
- Conclusions

A) Market Definition

Relevant Geographic Market

- Relevant geographic market: all of Germany (no local markets)
- Arguments:
 - DPAG has nationwide coverage
 - Some competitors cover almost the whole territory
 - Some local competition but not sufficient for separate markets (Current local competition result of licensing)
 - No indication for supra-national markets
- Conditions of competition appear sufficiently homogeneous to establish single national market

A) Market Definition

Relevant Product Markets (1)

- Methodology
 - Application of hypothetical monopolist test to define product markets
 - Demand-side substitutability
 - Homogeneity of conditions of competition
 - Qualitative analysis
- Results:
 - 11 relevant product markets identified
 - 7 retail markets (End-to-end)
 - 4 worksharing markets
 - No separate wholesale markets: Large mailers purchase same worksharing products as competitors and consolidators

A) Market Definition

Relevant Product Markets (2)

| | Market for: |
|-------------|---|
| End-to-end | 1. End-to-end letter services for business customers, first class (D+1) |
| | 2. End-to-end letter services for private customers, first class (D+1) |
| | 3. End-to-end letter services, second class (D+X) |
| | 4. International End-to-end letter services for business customers |
| | 5. International End-to-end letter services for private customers |
| | 6. Registered services for business customers |
| | 7. Registered services for private customers |
| Worksharing | 8. First class letter services (D+1) |
| | 9. Second class letter services (D+X) and minor presorting |
| | 10. Second class letter services (D+X) and major presorting |
| | 11. International letter services |

- Worksharing-markets: Those parts of the postal value chain which are done by the postal service provider **after** presorting by worksharers

B) Three Criteria Overview

- Three criteria are used to identify markets “the characteristics of which may be such as to justify the imposition of regulatory obligations”
 1. High and non-transitory entry barriers
 2. No tendency towards effective competition
 3. Application of competition law alone not adequate

B) Three Criteria Overview of Results

| Market for: | | 1. | 2. | 3. |
|-------------|---|----|----|----|
| End-to-end | 1. End-to-end letter services for business customers, first class (D+1) | x | | |
| | 2. End-to-end letter services for private customers, first class (D+1) | ✓ | ✓ | ✓ |
| | 3. End-to-end letter services, second class (D+X) | x | | |
| | 4. International End-to-end letter services for business customers | x | | |
| | 5. International End-to-end letter services for private customers | ✓ | ✓ | ✓ |
| | 6. Registered services for business customers | x | | |
| | 7. Registered services for private customers | ✓ | ✓ | ✓ |
| Worksharing | 8. First class letter services (D+1) | x | | |
| | 9. Second class letter services (D+X) and minor presorting | x | | |
| | 10. Second class letter services (D+X) and major presorting | x | | |
| | 11. International letter services | x | | |

B) Three Criteria

1st Criterion: Entry barriers (1)

| | Market no 2 (E2E, private customers) | Market no 8 (Worksharing, first class) |
|---|---|---|
| High sunk costs an entry barrier? | Investments in vehicles, facilities, sorting machinery: not sunk | |
| | <ul style="list-style-type: none"> • Access network: investments in outlets and letter boxes are high compared to small size of market for private customers • Marketing: expensive in mass markets | <ul style="list-style-type: none"> • No access network required • Lower Marketing expenses due to : <ul style="list-style-type: none"> - Small customer base - Public institutions must tender |
| Economies of scale an entry barrier? | Pro <ul style="list-style-type: none"> • Competitors have low volumes • EoS can be an entry barrier particularly in areas with high delivery cost Con <ul style="list-style-type: none"> • 2007: Strong infrastructure competition – market entry in all parts of Germany despite monopoly • Several private operators plan nationwide delivery by 2008 | |
| VAT exemption an entry barrier? | <ul style="list-style-type: none"> • Clear disadvantage for competitors | <ul style="list-style-type: none"> • Disadvantage for competitors for part of the market (senders that cannot reclaim input VAT) |

B) Three Criteria

1st Criterion: Entry barriers (2)

- Conclusions market no 2
 - Barriers to entry exist. Key arguments
 - Access
 - Advertising
 - Continue with 2nd criterion
- Conclusions market no 8
 - No barriers to entry
 - No ex ante price regulation

Market no 2: End-to-end letter services for private customers, first class (D+1)

Market no 8: Worksharing market for first class letter services (D+1)

B) Three Criteria

2nd Criterion: Effective Competition

| | |
|-------------------------------|---|
| Competition up to date | <ul style="list-style-type: none"> • Competitors' market share for letter services up to 1 kg ~ 10 % in 2006 (business and private customers!) • Market share for private customers: very low • Very few access points • Most competitors copy products of DPAG |
| Customer behaviour | <ul style="list-style-type: none"> • No customer survey available (for Germany) • Transaction costs relevant for private customers |
| Future development | <ul style="list-style-type: none"> • 2008: full liberalisation • Competitors plan to extend access network • Some plan nationwide delivery network • Strong reputation of DPAG may slow down development of competition |

- No effective competition up to date
- Speedy development towards effective competition after 2008 not likely
- Conclusion: No tendency towards effective competition for private customers after 2008 expected in the relevant time horizon

B) Three Criteria

3rd Criterion: Competition Law Adequate

- Application of competition law alone does not appear to be adequate to remedy the market failures (in market no 2)
- Problems with the application of competition law alone in the postal sector
 - Ex post only
 - Competition authorities can not positively prescribe behaviour
 - Proof of price abuse extremely difficult
 - Cost structure in letter markets requires regular monitoring
 - Regular abuse of market position can be expected

→ Conclusion: 3rd criterion is met in market no 2

C) Significant Market Power?

- Does DPAG have SMP on End-to-end-markets for private customers?
 - Clear indications that DPAG has SMP on markets for private customers
- Market share of DPAG
 - ~ 93 % for private and business customers (letters up to 1 kg)
 - Exact market share for private customers unknown – must be significantly above 93 %

D) Choice of Remedies

- Which regulatory measures are adequate? Remedies have to be proportionate
 - Regulation of wholesale markets
(No wholesale-based products for private customers supplied)
 - Transparency and non-discrimination
 - Obligation to provide unbundled services
 - Cost accounting rules
- Not sufficient against price abuse
- Ex ante price regulation seems to be necessary for the protection of private customers

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Conclusions

- General conclusions:
 - Methodology (3 criteria by EU Commission) seems applicable to postal markets
 - Test may yield different results in other countries
- Germany:
 - Ex ante price regulation in end-to-end-markets for private customers appears appropriate
 - But overly excessive for other markets
 - Review of bulk mail exemption (>50 pieces) in German postal law: Generally adequate but customer survey useful to review exact dividing line (50 pieces)

Conclusions involve predictions about situation after liberalisation and absence of regulation



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