

# **The Future of the Postal Sector and Regulation\***

*Michael A. Crew, CRRRI Professor of  
Regulatory Economics and Director CRRRI*

\*Based on WIP with Paul  
Kleindorfer, INSEAD

# Outline

1. The Setting: the current state and the new reality
2. Issues resulting for POs and regulators
3. Responding to the New Reality
4. Concluding Implications for the Future of the Postal, Energy and Telecommunications Sectors

# The Setting: the current state and the new reality

- Good news, bad news
- Bleak outlook for postal sector
- Washington, DC, November 20, 2009
- Cloudy picture of other regulated industries
- Carbon involves all industries in varying degrees
- Regulation – a growth industry again

# Why is regulation a growth industry?

- Traditional role redistribution of monopoly rents
- Story of deregulation changing distribution in name of efficiency
- Large customers vs small
- Carbon, USO together with intermodal competition makes for new mix

# Carbon and USO

- Biggest question: How to pay?
- Who pays? Customers and labor
- Which customers?
- How to pay?
- Questions primarily for energy and postal regulators
- Putting the genie back in the bottle: rolling back market opening

# Some Important Components

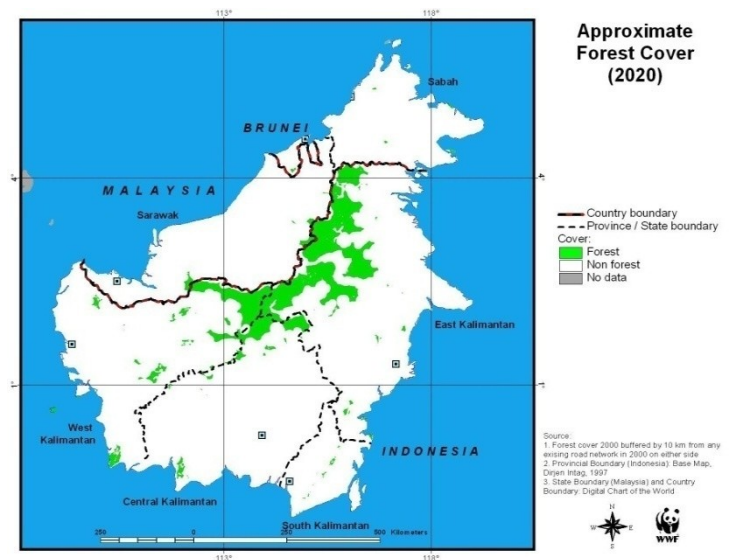
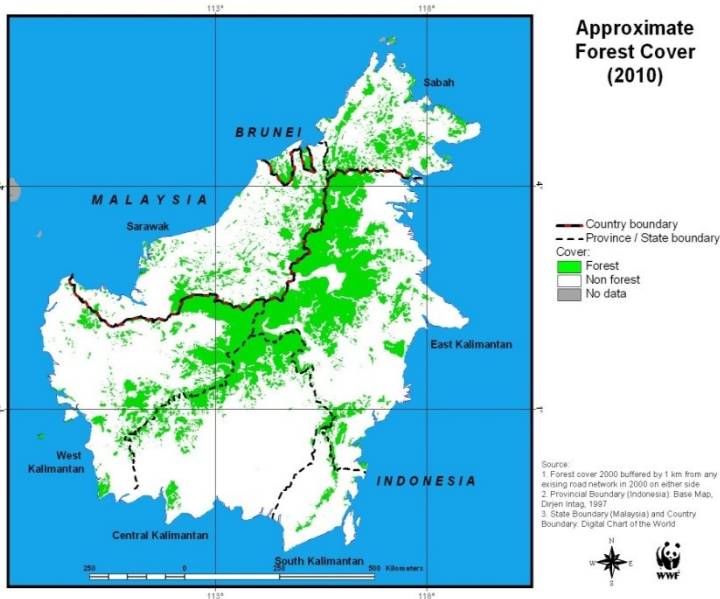
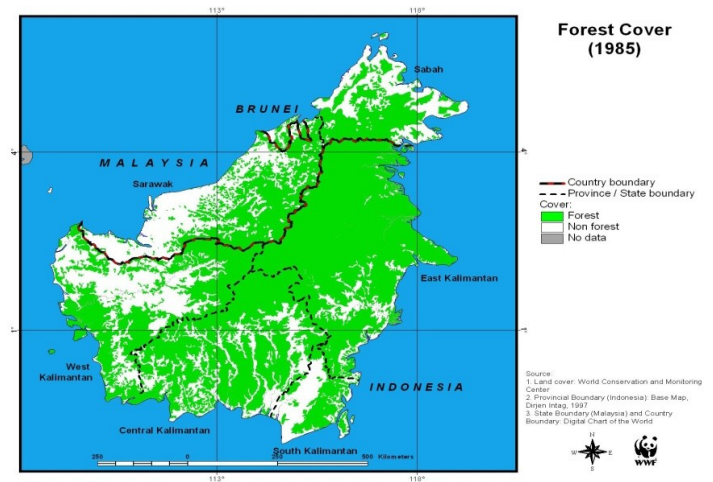
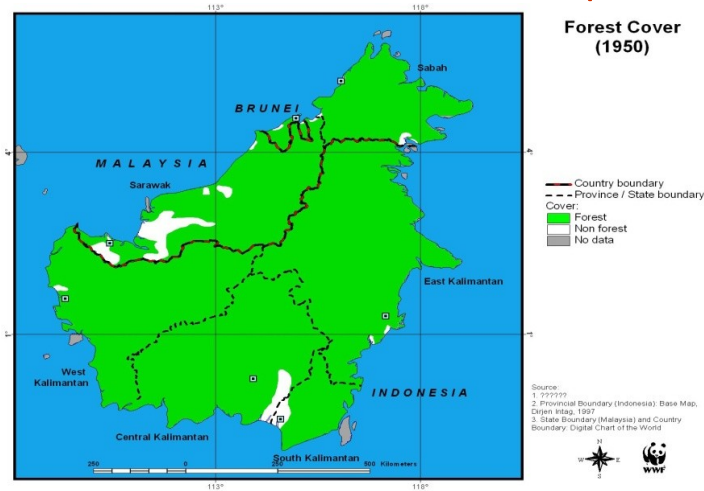
- Carbon reduction very costly
- Most untested – carbon sequestration, renewable portfolios problematical
- Nuclear tested but problem of public acceptance in US – greater load factor required because of high capital cost
- Electric vehicles – POs might be major application e.g. USPS – funding?

# Renewable Problems

- Expensive
- Wind unreliable and low capacity factor around 30%, second order quality effects
- Solar more reliable but construction cost needs to continue to come down
- Biofuel problems: corn ethanol, rapeseed
- Exporting the problem might work with water pollution but not carbon

# COMPETITION WITH FOREST COVER & Agriculture

## (PALM OIL in BORNEO)





# Issues resulting for POs and regulators

- Grim present – grimmer future?
- Regulators not faced anything like this as POs continued to jog steadily along
- Regulators expected to respond but can they solve the problems?
- Only partially

# General Regulatory Strategies

- Hands off
- Roll back FMO to reserved area
- USPS has faced (relatively) hands off regulation and has monopoly
- Mail volume down 15% over less than 2 years
- Under FMO excessively proactive regulation problematical – could lead to inefficient competition

# Role for Regulator

- (i) Single-piece price
- (ii) Managing the USO
- (iii) Access
- (i) and (ii) closely related
- Drop (i) drop a principal part of USO and lose clout in enforcing USO
- Carrots and sticks work along with price regulation e.g. ANACOM- CTT Correios and X-factor

# Responding to the New Reality

- Areas of concern: competition and USO
- Competition: FMO, access, intermodal competition
- The new competition different
- Different because changing so rapidly
- Email facing competition, Facebook, Twitter, Youtube, Skype and ???

# Intermodal competition

- Hurts mail as a communication medium
- As a transaction medium
- As an advertizing medium
- Helps parcel and packet business
- But serious competition e.g. UPS and FEDEX  
Ground for USPS
- Serious rethinking required by POs

# Re-inventing POs

- Integrating logistics with e-commerce
- Re-inventing mail as an advertizing medium
- Tracking, proof of delivery
- New conception of mail as premium product in contrast to email advertizing as the junk
- Rethinking access and worksharing
- New approach to and by labor
- Related diversification e.g. financial services

# Role of Regulator

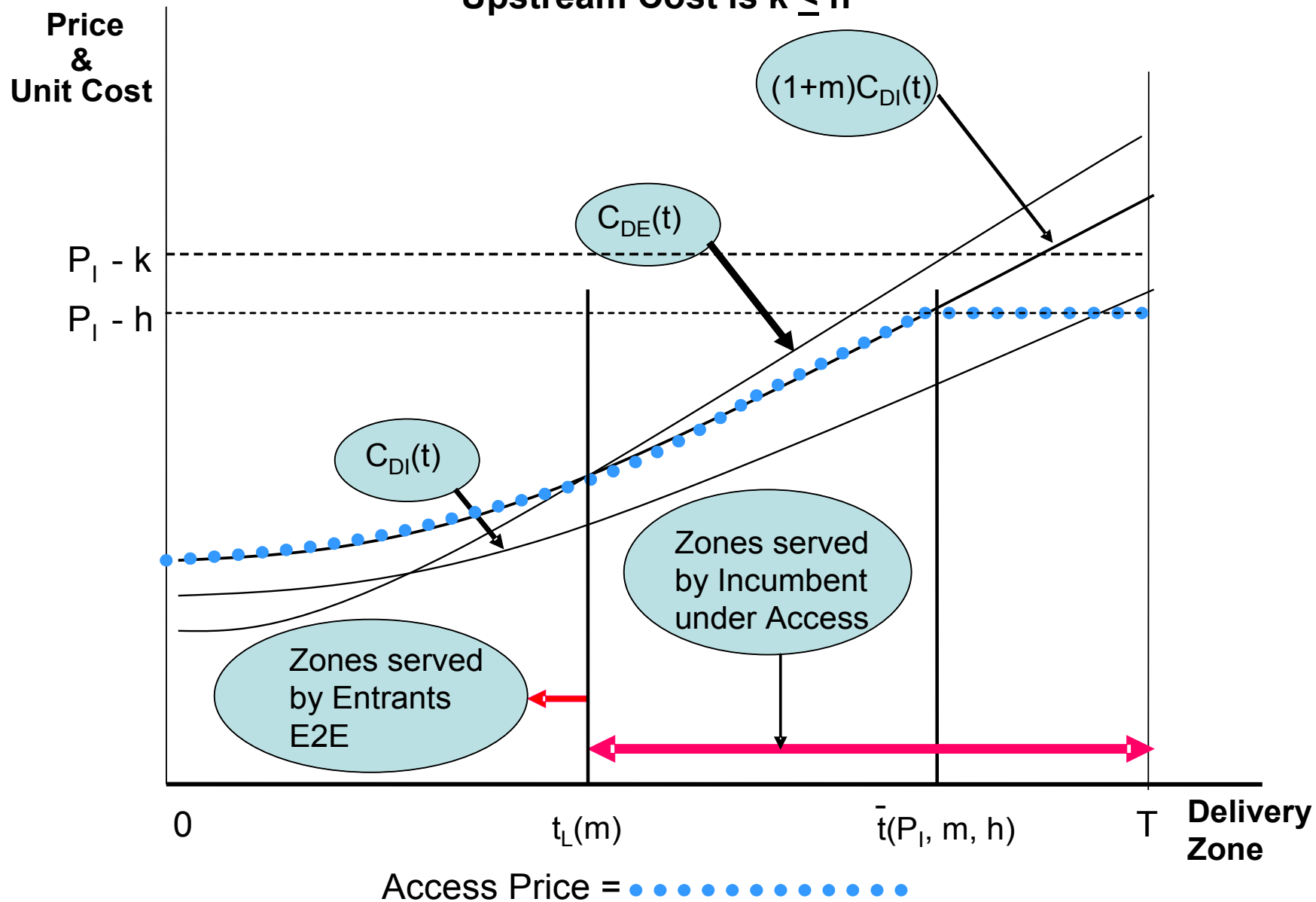
- No guarantee measures will succeed
- Regulator face issues of USO and competitors, e.g. access
- Access and worksharing needs rethinking especially for USPS where it is significant
- Role of access regulation remains important issue

# Access Regulation

- Case for no regulation is strong under FMO but unlikely to happen
- Probably greater risk of encouraging inefficient competition than exploitation of market power
- Backup provided by competition law
- Crew and Kleindorfer – Bordeaux 2009
- Figure summarizes problem



**Figure 1: Illustrating Zonal Access Pricing and Zones Served for an Entrant of type “k” when the Incumbent’s Minimum Discount is  $h > 0$  and Entrant’s Upstream Cost is  $k \leq h$**



# Access policy discussion

- If minimum discount  $h$  is set too high inefficiency results
- Loss of contribution to USO ( $m$ ) and loss per piece after  $\bar{t}$
- Inefficient competition entrants with  $k > C_{U1}$
- Issue of whether access regulation is worth the effort

# Lessons from Telecommunications

- *Prime facie* case for access regulation not so in postal (no fixed network)
- 1996 Telecommunications Act miserable failure
- Mobile and Internet competition made it moot
- Similar argument apply even more strongly in postal

# Regulator and USO

- Regulator as manager of USO
- Funding major issue under FMO
- Nature of USO
- Regulator best placed to manage process of reducing?? USO
- If USO reduced, single-piece price raised to acceptable limit what next?

# Directive and cost of USO

- Anticipating potential need for subsidy  
Directive raises costing USO
- Confusing situation because methods for costing problematical and confusion about Intangible benefits
- Intangibles accrue primarily to society and not POs

# Illustration of Problem

<b>Origin-Destination Pairs</b>	<b>Revenue Generated</b>	<b>Cost Incurred</b>	<b>Contribution Margin</b>
<b>Low to Low</b>	290	210	80
<b>High to Low</b>	60	40	20
<b>Low to High</b>	60	160	-100
<b>High to High</b>	20	30	-10
<b>Totals (all Origin-Destination Pairs)</b>	430	440	-10
<b>Net Cost of USO under NAC</b>		110	
<b>Net Cost of USO under NP</b>		90	

# Problems – NAC vs NP

- Table indicates two different answers
- NAC unrealistic counterfactual – no delivery to losing routes
- NP implicit assumption (Directive’s “reasonable profit”) profit implied by counterfactual (no USO )
- If regulated profit without USO \$60m (not \$80m) then NP \$70m, regulated profit level of \$60m minus profit under USO constraint (—\$10m)

# Problems – NAC vs NP (continued)

- NP theoretically correct but measurement problems may be insuperable.
- NAC gives somewhat precise estimates of the wrong measure!
- Because NAC is measurable may be tendency to use it



# Approach to Net Cost of USO

- If PO is profitable *ex ante* no change
- Next step to determine how to reduce USO
- Most obvious raising single-piece price
- Determining acceptable service levels
- Implementing a system of incentives for service levels to attain standard
- ANACOM current practice – possible role

# Concluding Implications for the Future

- Elephant in the room not going away
- Less role for access regulation, more pricing flexibility and competitor protection
- Greater need for price flexibility
- Environmental issues
- Major in energy – scale back rethink renewable, greater role for nuclear
- Electric vehicles and POs

# Concluding Implications for the Future

- Financing electric vehicle – major problem for USPS but possibly big benefits
- Do-not-mail laws issue in US
- Regulators may need to take position to avoid such laws
- Funding USO major issue requiring more (different) regulation