The current price regulation for the U.S. Postal Service’s market dominant products includes a price cap based on the Consumer Price Index (CPI). Previous work by the U.S. Postal Service Office of Inspector General (OIG) has shown that the existing price cap is unsustainable in the current environment of declining First-Class Mail volume.¹

Recently, stakeholders have expressed an interest in understanding how other major posts’ prices are regulated and how posts manage the relationship between price regulation, profitability, and service. With this question in mind, the OIG asked WIK-Consult (WIK), a consulting firm with expertise in international postal regulation, to provide research on how postal prices are regulated in five countries: Australia, Canada, France, Germany, and the United Kingdom. WIK’s report is in Appendix A. In this paper, we discuss several notable findings:

- Price regulation in these countries has not been static. In all of the five examined countries, the regulators revisited and modified price regulation to allow for greater pricing flexibility in response to changing market conditions. Changes occurred in two ways — reduction in the scope of products covered by regulation and allowance of higher price increases on regulated products. Most recently, the changes have allowed price increases that are greater than inflation.

- It appears that the combination of higher prices, efficiency gains from modernization, and growing parcel volumes have helped to stabilize the posts’ respective financial positions.

- In general, service has remained stable or declined slightly, but it is unclear what is driving this result. Price increases may have allowed the posts sufficient revenue to maintain service. However, it is also possible that service performance has been driven by better enforcement mechanisms or more achievable service goals.

Although the U.S. Postal Service differs in many respects from other posts, many of the regulatory challenges are the same. Both the key differences and similar challenges are important to keep in mind as price regulation for market dominant products continues to be a key focus of debate for the U.S. postal system.

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Background

Since the passage of the Postal Accountability and Enhancement Act (PAEA) in 2006, price increases for market dominant products have been limited by a price cap based on the Consumer Price Index (CPI). The CPI-based restriction on price increases has remained unchanged over the last 10 years, even with stagnant inflation and dramatically declining letter volumes. Although the U.S. Postal Service was allowed a temporary exigent surcharge to help make up for revenue losses due to the recession, this surcharge expired in April 2016 and the Postal Service still faces serious financial pressures. While the U.S. Postal Service has more pricing flexibility for its competitive products, market dominant products still make up a majority of its revenue and volume.

In 2013, the U.S. Postal Service Office of Inspector General (OIG) worked with LR Christensen Associates to provide an analytical analysis of current and alternative CPI caps. The main finding of the report was that the current CPI price cap is unsustainable with declining First-Class letter volumes. This is because the CPI cap does not allow price increases that reflect the fact that as letter volume declines, there are additional cost burdens placed on the remaining pieces of mail.

In response to our price cap paper and our discussion forums on Funding the Universal Service Obligation, stakeholders expressed an interest in learning more about how postal prices are regulated in other countries. The OIG asked WIK-Consult (WIK), a leading economic consultancy in Europe with expertise on postal regulatory and policy issues, to research and report on how prices are regulated in other posts. This report, found in Appendix A, provides a description of price regulation for five posts over the last 10 years, as well as information on the posts’ service and financial positions.

The five countries included in the report — Australia, Canada, France, Germany, and the United Kingdom — were chosen with careful consideration. We sought to include posts with higher volumes of mail and large geographic regions. In addition, we wanted to include countries with different price regulation approaches, including countries that have some form of price regulation that is not a price cap (Australia and Canada). Of the countries that have price caps, we wanted to include a variety of price cap regimes. Germany has a price cap formula, France has a forward-looking cap that uses forecasted cost and revenue information, and the United Kingdom has a very limited “safeguard cap.” The safeguard cap differs from other price caps in that it sets a very high ceiling — one that will most likely never be reached — to ensure that consumers will never be subject to outrageously high rates.

Throughout this paper, we use the term X-factor when discussing price caps. X-factors are traditionally used in price cap regulation to adjust the measure of inflation by some estimate of productivity change. For example, if inflation is 3 percent, an X-Factor may be used to limit the allowable price increase to 2 percent, to incentivize the post to seek productivity improvements. While X-factors are traditionally tied to productivity measures, it should be noted that there are no hard-set rules as to what they can or cannot include.

Another technical term used in this report is “reserved services” or “reserved area.” This refers to any mail products that only the post is allowed to provide. In the United States, we often refer to the reserved area as monopoly products.

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2 The current law allows the Postal Service to request price increases above the cap due to extraordinary or exceptional circumstances. This provision is often referred to as an “exigent rate case.” 39 U.S.C § 3622(d)(1)(E). The PRC allowed an exigent surcharge, but it was removed in April 2016. U.S. Postal Service, “Forced Price Reduction to Worsen USPS Financial Condition by $2 Billion Per Year,” February 25, 2016, https://about.usps.com/news/national-releases/2016/pr16_009.htm.
4 Ibid.
5 The OIG hosted two discussion forums on April 29, 2016. During the events, participants asked various questions about how prices were regulated in international posts.
Main Findings

As mentioned earlier, WIK’s comprehensive report, *International Price Regulation*, is found in Appendix A. Table 1 summarizes WIK’s key findings, which are discussed below.

**Table 1: Summary of WIK’s Research Findings**

<table>
<thead>
<tr>
<th>Current Price Regulation</th>
<th>Australia</th>
<th>Canada</th>
<th>France</th>
<th>Germany</th>
<th>United Kingdom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Notification and approval (cost based)</td>
<td>Rates are published and subject to approval</td>
<td>Price cap — forward looking cap with forecasted data (includes X-factor and inflation)</td>
<td>Price cap — formula with inflation and an X-factor</td>
<td>Safeguard price cap on second class</td>
<td></td>
</tr>
<tr>
<td>Current Scope</td>
<td>Non-priority stamped single-piece letters</td>
<td>All addressed letters up to 500g</td>
<td>Very broad. All universal service products</td>
<td>Domestic single-piece items and international outbound letter services</td>
<td>Single-piece second class mail up to 2kg</td>
</tr>
<tr>
<td>Percent of Mail That is Currently Price Regulated</td>
<td>&lt; 16% of volume of total letter mail</td>
<td>15% revenue from letters and parcels</td>
<td>At least 90% of total mail revenue</td>
<td>10 to 20% of total letter volume</td>
<td>&lt; 23% of addressed letters</td>
</tr>
<tr>
<td>Service Changes over 10 Years</td>
<td>Lower transit standards for new regular category</td>
<td>Stable transit time</td>
<td>Stable transit time</td>
<td>Slight decline in transit times</td>
<td>Improved transit times, but has not met goals</td>
</tr>
<tr>
<td></td>
<td>Stable # of post offices and agencies</td>
<td>Slight reduction in post offices and agencies</td>
<td>Stable # of post office and agencies</td>
<td>Stable # of post offices and agencies</td>
<td>Slight decline in # of postal outlets</td>
</tr>
<tr>
<td></td>
<td>Stable # of letter boxes</td>
<td>Reduction in letter boxes. Move to clusterboxes (on hold)</td>
<td>Reduction in letter boxes</td>
<td>Stable # of letter boxes</td>
<td>Stable # of letter boxes</td>
</tr>
<tr>
<td>Financial Situation over 10 Years</td>
<td>Profits overall declining; revenue from reserved area is relatively stable</td>
<td>Relatively stable revenues since 2007</td>
<td>La Poste has been profitable since 2007</td>
<td>Mail revenues stable since 2007</td>
<td>In recent years, revenues have increased due to higher prices and growing parcel volumes.</td>
</tr>
</tbody>
</table>

Source: OIG Summary of WIK Report.

**Price Regulation in Other Countries Changes over Time in Response to Market Conditions**

Price regulation in other countries has not been static. As seen in Table 2, the price regulation regime in the five countries studied has changed at least once, if not more, over the last decade. The most recent modifications appear to be in response to the need for additional revenue due to declining letter volumes. For all the countries in the study, the changes have allowed for increased pricing flexibility in one of two ways. The first is by decreasing the scope of products that fall under price regulation.

---

7 In some cases, non-regulated products are still partially regulated as they are tied to the single-piece rates. For example, in Australia, single-piece rates serve as an upper bound to business bulk mail prices. *Appendix A*, WIK-Consult, p. 2.
For example, in Australia, the scope of products that fall under price regulation was changed twice. The first time was in 2011, when it removed all but 16 percent of reserved letter services from price control. The second reduction in scope occurred in 2015, when the remaining price regulated letters were split into two new categories, regular and priority, with the new regular category having significantly lower delivery time standards than the original letter product. After the split, only the new regular letter category remained under price regulation.

Table 2: Summary of Changes to Price Regulation

<table>
<thead>
<tr>
<th>Price Regulation in Other Posts Is Not Static and Has Changed Recently in Response to Falling Letter Volumes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price Regulation in other countries has changed over time, most recently allowing for prices above inflation. These changes have occurred by reducing the scope of products under price regulation, by allowing higher price increases on regulated products, or both.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th>Canada</th>
<th>France</th>
<th>Germany</th>
<th>United Kingdom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price Regulation</td>
<td>Notification</td>
<td>Publish Rates</td>
<td>Price Cap</td>
<td>Price Cap</td>
<td>Safeguard Price Cap</td>
</tr>
<tr>
<td>Decreased Scope of Products</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Modification to Cap/Price Increase Calculation</td>
<td>Current rules allow higher prices when needed</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Most Recent Price Increase above Inflation</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Source: OIG Summary of WIK Report.

The second way that price regulation regimes have changed is by modifying how allowable price increases are calculated. This has occurred by several means. For example, in Canada, higher price increases were allowed after a price cap that limited price increases to 2/3 of inflation was eliminated, and the regulation reverted to a less formulaic price approval process. In contrast, in
France, the price cap remained, but in the most recent price change period, declining volumes increased the negative X-factor and allowed for higher price increases.  

In Germany and the United Kingdom, both changes occurred. There was a reduction in the scope of products that fall under price regulation and a modification to how the allowable price changes were calculated.

The United Kingdom is perhaps the most interesting example of increasing pricing flexibility. Prior to 2012, a price cap was applied to a broad scope of products. After 2012, only a safeguard cap remained on second class letters. Moreover, as discussed above, this safeguard cap is not a true cap, in that it sets a very high ceiling that the post will most likely never meet. For example, the safeguard cap on second class letters over 2 kg allows for prices that are 53 percent higher than the 2011/2012 prices, as well as allowing increases to account for inflation each year. Royal Mail’s regulator, Ofcom, put the safeguard cap in place in order to ensure that consumers will never be subject to outrageously high rates.

In addition to the safeguard cap, Ofcom put two other safeguard regulations in place. The first is a monitoring regime to observe various aspects of Royal Mail’s performance including financial performance, universal service, efficiency, pricing, and impact on competition. The second is a margin squeeze test to ensure access prices do not push competitors out of the market. These protected competitors, including entities which collect and sort the mail prior to entering it, are similar to the presort industry in the United States.

Overall, the Scope of Products Included under Price Limits Is Much Lower Than in the United States

With the exception of France, the countries examined in this study include far less mail volume and revenue under regulation that limits price increases. In the United States, all market dominant products fall under the CPI-price cap, and 100 percent of letter mail is in the market dominant category. In addition, market dominant products include more than letter mail. The market dominant categories First-Class Mail, Standard Mail, and Package Services all include letters, flats and parcels. In addition, Periodical Mail is in the market dominant category. In fact, overall, market dominant products encompass 97 percent of total mail volume and 76 percent of total mail revenue.

In contrast, most of the countries in this study have price regulation limits on a small portion of their letter mail, and often the price cap is limited to only single-piece letters (as shown in Table 1). For example, Australia Post’s price regulation only applies to non-priority stamped single-piece letters, which make up less than 16 percent of total letter volume and 13 percent of total letter revenue. In Germany, the price cap applies to domestic single-piece items and international outbound letter services, which comprises 10 to 20 percent of total letter volume.

Most of the countries in this study only have price limits on a small portion of their letter mail, often limited to single-piece letters.
Price Regulation in Other Posts Has Allowed Price Increases Greater Than Inflation

Price regulation in other posts has allowed price increases that are above inflation. In some cases, this is a recent change. For example, from 2003 to 2015, the allowable price increase in Germany was small and sometimes even negative. However, in 2015, the regulator had to revise its most recent price cap decision due to a change in postal regulation. This modification resulted in the X-factor becoming negative and allowing for a price increase of 7.5 percent, 5.8 percent above inflation.21

It is interesting to note that for several countries, the X-factor is the driving factor behind the greater-than-inflation price increases.22 In the United States, discussion of this issue generally implies that the inclusion of an X-factor will lower the price cap. However, it appears that with declining letter volumes, the X-factor can be used to account for the fact that there are fewer pieces of mail to carry the burden of universal service.

France is another example where the recent allowable price increases are significantly higher than in previous years. Prior to 2015, the annual price increase was below 3 percent. In contrast, in the 2015-2018 price cap period, the average annual increase allowed is 3.5 percent plus inflation.23 In addition, the new methodology allows for La Poste to use more of the allowable price increase in the first years of the price cap period. Each year, La Poste can request price increases that account for both inflation and a certain percentage of the cumulative X-factor over the 4-year period. Specifically, La Poste is allowed to use 50 percent of the allowable X-factor in the first year, 70 percent in the first 2 years, 90 percent over the first 3 years, and 100 percent over the entire price cap period.24 This is in addition to price increases allowed for inflation. The price regulation rules also include adjustment mechanisms that are triggered when actual data varies from forecasted data.25

Higher Price Increases, in Combination with Other Factors, Have Helped to Stabilize Finances

Overall, higher price increases have helped in part to stabilize the posts’ financial positions. For example, WIK found that in Germany, price increases essentially offset the small declines in letter volume.26 However, while price increases have certainly helped, WIK points to two areas that have also provided, or are needed to provide, financial support.27 The first is the growth in parcels. For example, WIK pointed out that Canada Post’s stable revenue is due to both the increase in prices on letter mail and growing parcel volume.28 The second factor associated with financial stability is gaining efficiencies through modernization efforts. For instance, WIK theorizes that Australia Post’s slow modernization efforts may be why the post is experiencing losses, even with higher prices on letters.29

Overall, No Major Degradations to Service

A concern in the United States is the impact on service of price controls as the Postal Service seeks to cut costs in response to declining letter volumes. Therefore, we asked WIK to include a few measures of service quality in its report: transit time, number of post offices and agencies, and number of street level boxes. As can be seen in Table 1, overall, there were no serious

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21 Appendix A, WIK-Consult, pp. 30-32.
22 This is sometimes referred to as a ‘negative’ X-factor.
23 Appendix A, WIK-Consult, p. 20.
24 Ibid., p. 22.
25 For example, the current X-factor is 3.5 percent so the cumulative total for the 4-year price cap period is 14 percent. La Poste may use 50 percent of this amount (0.5 X 14 = 7 percent) in the first year of the price cap period. This is in addition to an increase to account for inflation. Over the first 2 years, La Poste may apply up to 70 percent of the cumulative X-factor (0.7 X 14 = 9.8 percent) in addition to inflation. It should be noted that the allowable price increases each year may be impacted by adjustment mechanisms that are triggered when forecasted data used to set the previous years’ price increases varies from actual data. Ibid., p. 21.
26 Ibid., p. 34.
27 There may be other factors that have helped the posts financial positions in addition to those mentioned in this report.
29 Ibid., p. VIII.
degradations in service in these three categories. It is interesting to note, that in some cases, private industry was partially responsible for maintaining service. For example, Australia Post only operates a minority of the postal outlets in Australia; private owners run the rest.\footnote{Ibid., p. 8.}

WIK did find a few exceptions to maintaining service quality. For example, in Australia ordinary letters were split into two products, regular and priority, with the new “regular” having significantly slower transit times than the previously combined product.\footnote{Ibid., p. 9.} The other exception is Canada Post, which had a plan to move all delivery points to cluster boxes. However, while some delivery points were converted, this plan has been put on hold.\footnote{Ibid., p. 16.} While delivery mode was not specifically researched in this study, the proposal to move to cluster boxes was included for Canada Post, as it was widely regarded as a decline in service.

What is not known is the driving factor behind the posts’ success at maintaining service levels. It could be that having higher prices allowed the posts enough revenue to maintain their service. However, it could also be due to how service goals are developed and regulated. Perhaps the posts in this study have enforcement mechanisms that give the posts more incentives to meet their service goals. It is also possible that their respective service goals were designed to be realistically achievable under current market conditions.

\section*{Conclusion}

Recent changes to price regulation in other posts — Australia, Canada, France, Germany, and the United Kingdom — have provided them with more pricing flexibility. This pricing flexibility, along with growing parcel volumes and efficiency gains from modernization efforts, has led to relative financial stability without large degradations to service.

While there are differences between the U.S. Postal Service and other posts, many of the regulatory challenges faced by the posts we studied are similar to the ones faced by the U.S. Postal Service. Both the similar challenges and the key differences are important to keep in mind as price regulation for market dominant products continues to be a key focus of debate for the U.S. postal system.
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International Price Regulation

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Executive Summary

The Risk Analysis Research Center of the USPS Office of Inspector General has commissioned WIK-Consult to review postal price regulation in five countries: Australia, Canada, France, Germany, and the United Kingdom.

Overall, international experience shows that postal regulators around the world have allowed postal operators to increase prices above inflation to compensate for the effect of declining volumes on the average cost of a letter. There have been no major adverse effects on service quality.

International price caps typically apply only to single-piece mail, representing a small fraction in total volume. Prices for bulk mail are typically set under market conditions, subject only to ex post review by postal regulators or antitrust authorities.

Price cap systems with flexible X-factors, to be reviewed by the regulator periodically, have proven to be effective to control prices and ensure that they remain in line with cost trends. X-factors are quite different among different countries, but generally have become negative over the last years, reflecting increasing unit cost. Postal unit costs increase in many countries because volumes decline and, as a result, fixed costs must be shared by fewer postal items.

In all countries, except Canada, the current postal price regulation offers the postal operators a substantial degree of commercial flexibility. The scope of ex ante price regulated postal services was reduced during the last decade in all countries.

- Postal price regulation in Australia is based on a price notification process which is restricted to non-priority stamp single-piece items. Legislation offers substantial pricing flexibility to Australia Post, but notification of price changes must be made to the regulator ACCC for ex ante review. The ACCC allowed Australia Post to increase prices well above inflation and has objected to a price notification only once, in 2009.

- The Canadian approach to price regulation differs from other countries because the institutional set-up of the postal sector is fundamentally different in Canada: there is no separation between postal operations (Canada Post), the "regulator" (the Ministry), and the owner (the same Ministry). Canada Post is essentially an operational unit of a government department and, consequently, pricing decisions appear to be based on political decisions rather than on commercial considerations and have allowed for significant price increases during the last decade.
In France, Germany, and the UK, a price cap regulation is applied. The regulatory framework for price regulation in these countries is provided by the European Postal Directive. According to the Directive, prices for universal services have to be affordable and cost-oriented. To ensure cost-orientation, regulators in all three countries monitor and ensure that revenues of regulated services cover their costs.

The average price increase for a basket of services provided by a regulated operator is determined by the scope of the price cap, which is based on inflation and the projected increase in productivity (X-factor). Price increases for individual services within the basket may increase more or less than the average scope. Further, the scope of services included in the service basket, i.e. the scope of services subject to price regulation, differs between the countries:

- The French price cap regulation includes a broad scope of services and limits La Poste’s pricing flexibility in principle. However, French regulator ARCEP has generally followed La Poste’s line of arguments in the past ten years, and approved price increases above inflation several times.

- The German price cap regulation is restricted to domestic single-piece items (stamped and franked) up to 1,000g (~37oz). It includes both domestic and international outbound services. Unlike other postal operators in this study, until 2015, Deutsche Post’s prices were regulated by an "RPI-X" system with a positive X-factor, such that prices could increase only less than inflation. In the last price cap decision (for the period 2016-2018), however, German regulator Bundesnetzagentur has established a negative X-factor, allowing for higher price increases.

- After a period of tight regulatory price control by the previous postal regulator Postcomm, ending in 2011, the British regulator Ofcom introduced a more flexible price cap regime in 2012. Royal Mail now has full pricing flexibility, restricted only by a safeguard cap on its Second Class letters and large letters. This has allowed Royal Mail to increase prices above inflation for most products.

The quality of service of Deutsche Post, La Poste, and Royal Mail remained relatively stable during the last decade. Australia Post has deliberately reduced average service quality in 2015/16 as the statutory performance standard was amended to incorporate the introduction of a two-speed letter service as part of the postal reforms. In Canada, service quality was quite stable in the last decade, but there were controversial discussions about the decrease of delivery quality due to Canada Post’s intended switch from door-to-door mail delivery to the use of community mail boxes, an initiative that has been recently halted.

Generally, more pricing flexibility allows postal operators to better respond to market developments, particularly to declining revenues and volumes. The five postal operators
we have surveyed face somewhat different market and regulatory conditions, and report different levels of profit:

- The financial situation of Australia Post is under pressure given continuous letter mail volume decline. Over the past decade, prices were increased substantially (more than inflation) but Australia Post has still realized increasing losses from its letter mail services. However, the lack of profitability in Australia Post’s mail segment may also relate to a lack of modernization in postal infrastructure and operations in the past. In 2015, Australia has tackled this issue by launching a major program to modernize postal operations.

- The revenues of Canada Post’s mail segment, which includes all letter mail and parcel operations, remained relatively stable since 2007. This is due to growing parcel volumes, Canada Post’s continuous price increases, and the introduction of a new pricing scheme in 2014 to compensate for declines in letter mail volume.

- The financial situation of La Poste was under pressure when volume decline accelerated during the last few years. However, low EBIT margins in the mail segment may also point to a need for more substantial modernization of postal infrastructure and operations. Flexible price cap regulation in France has helped La Poste to compensate for volume losses by price increases, at least in part.

- Deutsche Post has seen only small declines in letter mail volumes in the last decade, and was able to keep revenues almost constant by modest price increases (since 2013).

- Royal Mail has clearly benefited from commercial flexibility granted by the new regulatory regime introduced in 2012, and streamlining of postal operations since 2008/2009. While letter volumes continued to decline, revenues were kept stable by increasing prices. Profits are now much higher than prior to 2012, both for the mail/parcel segment as well as for the whole group.
1 Introduction

This report was prepared between July and November 2016 for the Risk Analysis Research Center (RARC) of the USPS Office of Inspector General (OIG). The USPS OIG RARC has commissioned WIK-Consult (WIK) to review postal price regulation in five countries. WIK-Consult is a leading economic consultancy in Europe, focused on regulation and policy issues in telecommunications, postal services, and digitization and intelligent networks more generally.

WIK reviewed the development of price regulation methods for mail services in Australia, Canada, France, Germany, and the United Kingdom. The five benchmark countries present a diverse set of countries and a broad range of price regulation approaches. For each country, the study provides a review of

- methods for postal price regulation: current methods for price regulation and trends in the last five to ten years;
- development of price regulation methods for mail services (method, products included, detailed parameters of price cap, etc.); and
- development of service quality during the same time (delivery frequency, delivery standards, and accessibility).

For each country, WIK assessed the impact of price regulation on postal prices, profitability of postal operators, and service quality standards.

The study is based on extensive desk research supplemented by telephone interviews with regulatory authorities and postal operators. WIK gratefully acknowledges the constructive assistance provided by the USPS OIG RARC and the interviewees, who generously contributed their time and expertise in responding to our questions. While gladly acknowledging the assistance of all, the authors are, of course, solely responsible for the final report, including any errors it may contain.
2 Australia

2.1 Development of ex ante price regulation methods for mail services

Australia Post is subject to price regulation only for declared (notified) services, i.e. services in those markets where, in view of the minister, competitive pressures are not sufficient to achieve efficient prices and protect consumers. Part VIIA of the *Competition and Consumer Act 2010* contains a price notification provision which obliges Australia Post to notify the Australian Competition and Consumer Commission (ACCC) if it proposes to increase the price of a declared service, introduce a new service that would fall within the definition of declared services, or change terms and conditions of an existing declared service.¹

2.1.1 Services covered by price regulation

Historically, all letter services reserved to Australia Post have been declared services, i.e. subject to price regulation. Reserved services include all letter mail products up to 250g.² They comprise 21 products in four service groups (Small Letters Ordinary, Small Letters Presort, Large Letters Ordinary, Large Letters Presort). In 2011, the Australian Government limited price regulation of Australia Post letter services from all reserved services to reserved ordinary letters³ including three prices:

- The uniform rate for an ordinary small letter (the basic postage rate),
- The price for large letters of up to 125g,
- The price for large letters of over 125g up to 250g.

Ordinary letters account for around 16 per cent of Australia Post’s domestic reserved letter service volume⁴ or for around 13 per cent of Australia Post’s letter mail revenues⁵ and are predominantly stamped mail. Despite the small share of volume and revenue, the ordinary letter service plays a prominent role for Australia Post’s business. In addition to fulfilling the key requirement of providing a basic letter service to all Australians at a uniform rate, the ordinary letter service acts as an anchor service and price for the larger part of the letter services, e.g. as the upper bound for business bulk mail prices.

In November 2015, Australia Post lodged a Draft Price Notification following the introduction of the most significant regulatory reform of Australia’s letter service in more

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¹ Australian Postal Corporation Act 1989, Act No. 64 of 1989 as amended up to Act No. 156 of 2007, Sections 29 and 30, Division 2 of Part 3; *Competition and Consumer Act 2010*, Part VIIA.
² Australian Postal Corporation Act 1989, Act No. 64 of 1989 as amended up to Act No. 156 of 2007, Sections 29 and 30.
³ Price Notification Declaration (Australia Post Letter Services) (No. 2) 2011.
⁴ See Australia Post, Draft Price Notification - Changes to Australia Post’s Ordinary Letter Service, p. 19, August 2015.
⁵ ACCC, Decision on Australian Postal Corporation 2015 price notification, December 2015, p. 10.
International Price Regulation

than 20 years. Central to the reform is the introduction of a two-speed letter service: ‘Priority’ letter service and ‘Regular’ letter service delivered with a slower delivery timetable.\textsuperscript{6} At present, senders have to affix a priority label to the regular letter services to send as a letter as Priority, which is sold at a uniform price of 0.50A$. According to a recent decision by the Australian Government, only the Regular letter services (i.e. ordinary small letter, ordinary large letters up to 125g, and ordinary large letters of over 125g up to 250g) will be treated as a declared service. Priority letter services will be regarded as a commercial service, which will not need to be notified to the ACCC. This holds as long as the price for the Priority letter service is at most 50 per cent more expensive than the price for the Regular letter service. If the price of the Priority letter exceeds the price of Regular by more than 50 per cent, it will again become a notified service.\textsuperscript{7}

2.1.2 Technical details of price regulation method

Australia Post is required to notify the ACCC if it proposes to increase the price of a notified service. For this purpose, Australia Post lodges a draft notification and provides the ACCC information and documents to support the proposed price increase. The ACCC will assess the proposed increases and decide whether to object or not object to the proposed charges. The ACCC’s preference is to adopt an assessment process which reflects the individual characteristics of each price notification.\textsuperscript{8}

In general, the ACCC adopts a cost-based approach to assess the price notifications and the extent to which the prices proposed by the declared firm are commensurate with the efficient costs of providing those services. The ACCC applies a building block model, the post-tax revenue model (PTRM), to inform its view on whether or not the proposed price increases are expected to recover the efficient costs of providing the declared services. For this purpose, all costs including operating costs, depreciation, return on capital, and tax are aggregated to derive maximum allowable revenue:\textsuperscript{9}

\[\text{Allowed revenue} = \text{operating costs} + \text{depreciation} + \text{return on capital} + \text{tax}.\]

The return on capital is based on a weighted average cost of capital (WACC) and reflects the rate of return commensurate with the risks faced by Australia Post, without achieving excessive or monopoly profits.

Historically, the ACCC applies a ‘dual-till’ regulatory pricing approach, whereby the appropriateness of the proposed prices were assessed with reference to a building

\textsuperscript{6} Australian Postal Corporation Act 1989, Act No. 64 of 1989 as amended up to Act No. 156 of 2007, Sections 29 and 30, Division 2 of Part 3.
\textsuperscript{7} The current Australia Post price notification declaration is available on the ACCC website https://www.accc.gov.au/system/files/Price%20Notification%20Declaration%2028Australia%20Post%20Letter%20Services%28%29%28No%2920%2820%292015.pdf
\textsuperscript{8} ACCC, Statement of regulatory approach to assessing price notifications, June 2009, p. 9 sqq.
\textsuperscript{9} ACCC, Statement of regulatory approach to assessing price notifications, June 2009, p. 15 sqq.
block model applied to the costs and revenues of overall reserved services. This implies that the shared cost of reserved and non-reserved services must be separated into the portion used in providing the reserved service and the portion used by the non-reserved services.\(^ {10}\)

The assessments of Australia Post’s recent price notifications have involved several steps. First, Australia Post’s cost allocation methodology (CAM) was reviewed. Australia Post’s CAM is a cost model which utilizes Activity Based Costing (ABC) as its cost allocation methodology. All resources, i.e. cost inputs, are consumed by activities and activities are consumed by products and services. This approach systematically breaks down recorded postal expenditures into established product and services cost categories. ACCC’s review of the CAM aims to ensure that there is no systematic bias or distortion in the cost allocation to products.\(^ {11}\) Secondly, ACCC reviewed and assessed Australia Post’s cost and demand forecasts and the effect of the proposed price changes on forecast revenue. Thirdly, Australia Post’s proposed rate of return on capital and the underlying calculations of the weighted average cost of capital (WACC) were reviewed and assessed.

ACCC’s reviews and assessment do not follow a specified methodology due to the individual characteristics of each price notification and the supporting documents and submissions. Customarily, the ACCC tests the sensitivity of the results to several key factors, e.g. alternative WACC or hypothetical assumptions in the CAM, and considers international benchmarks and empirical studies for the assessment of cost efficiency and volume and cost forecasts. For example, the ACCC assessed the cost efficiency and projected impact of the two-speed letter service and other business reforms on Australia Post’s costs in the last price notification by comparing it with cost savings of overseas postal operators (Deutsche Post, La Poste, PostNL, PostNord Danmark, and PostNord Sweden) undertaking similar reforms.\(^ {12}\)

\(^ {10}\) ACCC, Australia Post price notification for its ‘ordinary’ letter service– ACCC Decision, February 2014, p. 8.
\(^ {11}\) Wik-Consult, Review of Australia Post Cost Allocation Methodology, Study for the ACCC, November 2015.
\(^ {12}\) ACCC, Decision on Australian Postal Corporation 2015 price notification, December 2015, and related consultation documents.
2.2 Key market developments

2.2.1 Prices and volumes

Australia Post lodged five price notifications for customer letter services in the last decade and justified the proposed price increase with the continuous letter volume decline. While letter mail volumes were relatively stable between 2007 and 2011, addressed mail volume declined by 6.6 per cent per annum (p.a.) and volume of reserved services declined by 5.8 per cent p.a. between 2011 and 2015. The ACCC objected to only one notification in 2009 and Australia Post was allowed to increase its consumer tariffs for letters four times during the last ten years. On average, prices for the notified services increased by around 8 per cent p.a. since 2007 (see Figure 1).

For small and standard letters, the prices increased between 2008 and 2015 by approximately 17 per cent in total or 3.5 per cent p.a. on average. In January 2016, Australia Post increased the price for small and standard letters and decreased delivery standards at the same time: priority letters (the old regular) increased from 0.70A$ to 1A$. This implies a price increase for regular letters of 40 per cent. In order to send priority letters, senders have to affix a priority label, which is currently sold at a cost of 0.50A$ which yields to a price for a small priority letter of 1.50A$. Consequently, prices increase even further if letter services with the same delivery standards are compared, i.e. the old regular with the new priority. For example, the price for small letters with the fastest delivery timetable increased by 114 per cent.

Figure 1  Price and volume development in Australia (chain index: 2007=100)

Source: WIK-Consult based on Australia Post, Price lists.
Notes: Annual prices as of end December. Price in 2016 as of end June.
* Letter volumes refer to financial years; 2015 = FY 2014/15; 2016 figure: estimate.
2.2.2 Financial situation

It seems that the approved price increases in 2008, 2010, and 2014 allowed Australia Post to compensate for the decline of (reserved) letter mail volume to some degree. Australia Post’s revenues in the letter mail segment were relatively stable until 2011. Between 2011 and 2015, the letter mail revenues decreased by 6.6 per cent p.a. on average. Interestingly, the revenues from reserved services (including notified services) remained stable and decreased by less than 1 per cent p.a. on average since 2007, implying that revenues from non-reserved services (e.g. letter mail items above 500g, unaddressed advertising, publications) decreased more. These developments are also reflected in the development of Australia Post’s EBIT margin for the letter segment and for reserved services. While the EBIT margin in the letter segment decreased by 24.6 per cent from 6.0 per cent in 2007 to -18.4 per cent in 2015, the EBIT margin of reserved services decreased less, i.e. by 17.6 per cent from 1.3 per cent in 2007 to 16.3 per cent in 2015 (see Figure 2).

Figure 2 Revenue and EBIT margin (Australia)

Source: WIK-Consult based on Australia Post, Annual Reports.
Letter mail revenues include revenues from reserved and non-reserved letter mail services.
2.2.3 Service quality

Australia Post is required to serve 98 per cent of all delivery points daily (except Saturday, Sunday or on public holidays in the place where delivery takes place) and 99.7 per cent of all delivery points at least two days per week. In the last decade, this statutory delivery frequency standard was met by Australia Post. Furthermore, Australia Post is required to deliver 94 per cent of all reserved services letters within the statutory performance standard as laid out in the Australian Postal Corporation (Performance Standards) Regulation 1998. In 2015, the statutory performance standard was amended to incorporate the introduction of a two-speed letter service as part of the postal reforms. The previous statutory delivery standards and the changes in the delivery timetables are summarized in Table 1 below.

Table 1 Statutory performance standard and Australia Post’s delivery timetables

<table>
<thead>
<tr>
<th></th>
<th>“Old” regular</th>
<th>“New” Priority</th>
<th>“New” Regular</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intrastate</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Metropolitan area to Metropolitan area</td>
<td>D+1</td>
<td>D+1</td>
<td>D+3</td>
</tr>
<tr>
<td>Metropolitan area to Country</td>
<td>D+2</td>
<td>D+2</td>
<td>D+3</td>
</tr>
<tr>
<td>Country to Country</td>
<td>D+2</td>
<td>D+2</td>
<td>D+4</td>
</tr>
<tr>
<td>Interstate</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Metropolitan area to Metropolitan area</td>
<td>D+2</td>
<td>D+2</td>
<td>D+5 (D+4*)</td>
</tr>
<tr>
<td>Metropolitan area to Country</td>
<td>D+3</td>
<td>D+3</td>
<td>D+6 (D+5*)</td>
</tr>
<tr>
<td>Country to Country</td>
<td>D+4</td>
<td>D+4</td>
<td>D+7 (D+6*)</td>
</tr>
</tbody>
</table>

Source: Based on Australian Postal Corporation (Performance Standards) Regulations 1998 and Australian Postal Corporation (Performance Standards) Amendment (Speed of Mail Delivery) Regulation 2015.

Note: * The statutory performance standard actually differs from Australia Post’s established timetable which foresees D+4 (Metropolitan area to Metropolitan area), D+5 (Metropolitan area to Country), and D+6 (Country to Country) for “New” Regular interstate delivery.

Australia Post’s transit time performance for reserved services has been relatively stable during the last ten years (see Figure 11) with on-time delivery rates of 95.6 per cent on average, well above the target of 94 per cent.

14 Australia Post, Annual Reports 2008 to 2015.
Figure 3  Transit time (Australia)

Source: WIK-Consult based on Australia Post, Annual Reports.

Figure 4 below illustrates the accessibility of postal services in Australia. The total number of post offices and the share of franchised Post Offices (agencies) situated in supermarkets or other stores has been stable since 2007. Today, only a minor and slightly declining share (approximately 16 per cent) of the postal outlets are operated by Australia Post’s staff. The number of street letter boxes remained relatively stable since 2007 and is, with around 15,000 street letter boxes throughout the country, well above the statutory requirement of 10,000 street letter boxes.

Figure 4  Access points (Australia)

Source: WIK-Consult based on Australia Post, Annual Reports.
2.3 Conclusion

The postal price regulation in Australia is based on a price notification process which is restricted to only a few services (non-priority stamp single-piece items) and provides Australia Post with a high degree of commercial flexibility. ACCC’s decision on Australia Post’s price notifications, particularly the recent decision on the proposed introduction of two-speed letter mail services which allowed for a substantial price increase and reduction in quality (slower transit time standards), show that ACCC generally accepts the company’s line of arguments motivating the need for price increases.

The financial situation of Australia Post is under pressure given the continuous letter mail volume decline in the last decade. Despite substantial price increases, Australia Post has realized increasing losses from its letter mail services which resulted in an EBIT margin of Australia Post Corporation of -5.5 per cent in FY 2014/2015 (compared to +6.7 per cent in FY 2010/2011). The declining profits in the mail segment may also be the result of slow modernization of the postal infrastructure and sorting operations. Indeed, Australia Post acknowledges urgent needs for reforms and efficiency improvements and has recently launched a major programme to re-organize postal operations.\textsuperscript{15}

\textsuperscript{15} See WIK-Consult (2015), Review of Australia Post Efficiency Program in light of international benchmarks, Study for the ACCC, November 2015.
3 Canada

3.1 Development of ex ante price regulation methods for mail services

Canada Post was initially regulated by direct ministerial control and later by the Postal Services Review Committee (PSRC), a third party regulator. The PSRC was disbanded in 1990 and the regulatory system reverted to inactive ministerial regulation. Canada Post is now granted ostensible autonomy in proposing regulations in postal matters. In accordance with the key legislation, the Canada Post Corporation Act, Canada Post may make regulations in relation to postal matters. Proposed changes to regulations, including postal rates, must be published in the Canada Gazette, and are subject to the approval of the Governor in Council (Canadian federal cabinet).

3.1.1 Services covered by price regulation

Canada Post is given the sole and exclusive right of collecting, transmitting, and delivering letters within Canada. All addressed letter mail services up to 500g are generally subject to price regulation. The Canada Post Corporation Act permits Canada Post to offer rates that differ from regulated rates under certain circumstances; for example, when senders prepare mailings in a manner that facilitates processing (e.g. bulk mail, metered mail). Consequently, price regulation actually applies to single-piece items only and the legislative objective of “fair and reasonable” postage rates addresses primarily private households and small business, i.e. low volume senders. However, the regulated service charges act as a price anchor for letter services by serving as an upper bound for business bulk mail prices.

Table 2 Canada Post’s regulated letter services

<table>
<thead>
<tr>
<th>Standard letters</th>
<th>Other letters</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;30g Single stamp</td>
<td>&lt;50g Booklet, coils or panes</td>
</tr>
</tbody>
</table>

Currently, there are eight domestic letter mail services within the range of reserved services which distinguish two format standards and eight weight categories (see Table 2). In March 2014, the Government approved regulations that allowed a new rate

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18 Canada Post Corporation Act 1985, 19 (2).

19 The terms “standard letters” and “other letters” refer to Canada Post’s product and format specifications, i.e. standard letters include letters no more than 245mm in length, 156mm in width, or 5mm in thickness.
structure under which stamps for letters below 30g that are sold in booklets, coils or panes are offered for a price below the price for single stamps.  

In 2015, the revenues from services charged at regulated prices represented 15 per cent of Canada Post’s revenues from letter mail and parcel services.

3.1.2 Technical details of price regulation method

For many years, price increases for the basic stamp were kept well below inflation through a price cap, which limited the annual price increases of stamps to two-thirds the rate of inflation as measured by the consumer price index. The price cap was repealed in 2009 and Canada Post received regulatory approval to increase its domestic basic letter charge by three cents in 2010 and by two cents annually from 2010 to 2014.

In accordance with the Canada Post Corporations Act, any change to the rates must be done through a regulatory amendment: Canada Post must publish its proposed changes to postal prices in the Canada Gazette to provide interested parties an opportunity to complain to the Minister responsible for Canada Post. The proposed change and the amendment becomes effective 60 days after the publication unless it is rejected by the government. Canada Post may prescribe rates of postage, subject to being “fair and reasonable and consistent so far as possible with providing revenue from other sources sufficient to defray the costs incurred by the Corporation.”

For the publication, Canada Post provides a Regulatory Impact Analysis Statement that provides background information and a description of the issues and proposed amendments. Further, Canada Post provides a statement of the costs and benefits of the amendment, for example, by providing an estimate of the burden of the proposed price increase for Canadian households (in CAD per year) or an estimate of the additional revenues.

In summary, it appears that price regulation in Canada is based on political decisions rather than on a fixed economic methodology.

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20 Canada Post Corporation Act, Letter Mail Regulations.
21 Canada Post, Annual Report 2015.
22 Consumer Postal Council (2012), Index of Postal Freedom – Canada.
23 See Canada Post Corporations Act 1985, s. 19 (1) and 19 (2).
24 See, for example, Canada Gazette, Vol. 149, No. 28, July 11, 2015; Canada Gazette, Vol. 146, No. 21, May 26, 2012.
3.2 Key market developments

3.2.1 Prices and volumes

Between 2007 and 2014, Canada Post amended the Letter Post Regulation and increased prices annually. The increase in prices was justified by the fragile financial sustainability due to a number of factors, i.e. declining letter mail volumes. Since 2007, addressed letter mail volume declined by 4.6 per cent p.a. on average whereas prices increased by around 6 per cent p.a. on average (see Figure 5).

Figure 5  Price and volume development in Canada (chain index: 2007=100)

Source: WIK-Consult based on Canada Post, Price lists.
Notes: Annual prices as of end December. Price in 2016 as of end June. Letter mail volume (addressed): domestic and cross-border inbound letters including publications.

In 2014, Canada Post introduced a new tiered pricing structure for domestic stamped mail to better reflect the cost of serving various customer segments. The price for standard letters below 30g was changed such that the majority (98 per cent) of consumers who buy stamps in booklets or coils have to pay 0.85 CAD per stamp, representing a 35 per cent increase over the 2013 stamp price, whereas consumers who

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26 Addressed letter mail includes correspondence / transactional mail (i.e. standard letters, post cards), addressed advertising mail, press and publications. Regulated letter services are a subset of addressed letter mail.
27 Canada Post specification: standard letters are letters no more than 245mm in length, 156mm in width, or 5mm in thickness product specifications.
purchase single stamps have to pay 1.00 CAD per stamp, representing a 59 per cent increase over the 2013 stamp price.\(^{28}\)

3.2.2 Financial situation

The revenues of Canada Post Segment, which includes all letter mail and parcel operations, remained stable. This is because both the increasing parcel revenues and Canada Post’s price increases on letters compensated for the constant letter mail volume decline between 2007 and 2013 almost entirely. Revenues from addressed letter mail decreased by only 1.3 per cent p.a. on average, given a volume decline of 4.6 per cent p.a., and revenues from transactional mail (i.e. standard letters, post cards etc.) declined by only 1.1 per cent on average, given a volume decline of 4.3 per cent p.a.

In 2011, Canada Post realized losses for the first time in 17 years due to continued decline in core mail volumes, the impact of a painful work disruption, and the negative impact of a pay-equity decision by the Supreme Court of Canada.\(^{29}\) From 2011 to 2013, Canada Post suffered three consecutive years with losses. However, they became profitable in 2014, after the introduction of the new tiered pricing structure for domestic stamped mail and measures to decrease costs, e.g. by franchising postal outlets, streamlining operations, and switching from home delivery to community mail boxes. The rate increases in 2014 contributed an additional 214 million CAD revenue in 2014 and 107 million CAD in 2015.\(^{30}\)

The significant price increases for stamp letter mail ensured that revenues from stamp postage remained stable over time. With the introduction of the new pricing scheme, Canada Post also introduced new rebates for customers that pay the postage by way of postage meters as a commercial service. Due to this change and the reporting of meter postage as revenue from a commercial service instead of a regulated service, the revenue share of price regulated services decreased significantly from 28 per cent in 2013 to 15 per cent in 2014 and 10 per cent in 2015.

\(^{30}\) Canada Post Annual Report 2014, p. 40; Canada Post Annual Report 2015, p. 44.
3.2.3 Service quality

In 2009, the Canadian Government established the Postal Service Charter, which outlines the expectations concerning Canada Post’s service covering universal service, rates, delivery, access to postal services, security, outreach, and consultation and response to complaints. Canada Post is required to serve daily all delivery points in Canada (except Saturday, Sunday or on public holidays in the place where delivery takes place and except in remote areas, where less frequent service may be necessary due to limited access to the community). The statutory delivery timetable is variable, subject to the origin and destination of the mailpiece, this is summarized in Table 3 below.31

<table>
<thead>
<tr>
<th>Delivery timetable</th>
</tr>
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<tbody>
<tr>
<td>Local (destination city/town is the same as the originating city/town)</td>
</tr>
<tr>
<td>Provincial (within a province)</td>
</tr>
<tr>
<td>Regional (between provinces)</td>
</tr>
</tbody>
</table>

31 Minister of Transport, Canadian Postal Service Charter, 2009.
Canada Post’s transit time performance services has been relatively stable during the last ten years (see Figure 7) with on-time delivery rates of 95 per cent on average including a lower on-time performance in 2011 due to labor disruption. There is no statutory performance standard in the Canadian postal legislation but Canada Post has published an own performance goal of 96 per cent on-time delivery until 2009 in its annual reports. It seems that Canada Post decreased its performance goal thereafter as Canada Post stated that they were “above target for on-time delivery”\(^{32}\) and “exceeded on-time service performance targets”\(^{33}\) in 2012 and 2013, although the on-time delivery performance was below 96 per cent in these years. Since 2012, delivery performance is slightly decreasing.

Figure 7   Transit time (Canada)

Source: WIK-Consult based on Canada Post, Annual Reports.

Canada Post slightly reduced the accessibility of postal services in the last decade. The number of postal outlets was reduced by 5.5 per cent since 2007. In 2013, around 60 per cent of postal outlets were post offices owned by the Corporation whereas the rest were composed of postal franchises, operated by authorized private dealers and conventionally located as a “store within a store”. Additionally, there were around 15,000 private establishments known as stamp shops, located in grocery or convenience stores and gift shops, which provide basic postal services (e.g. sell stamps).\(^{34}\) The number of street letter boxes was reduced by around 40 per cent between 2008 and 2015. However, street letter boxes only represent a minor share (less than 5 per cent) of the collection points as the majority are rural mailboxes, which serve as collection and delivery points (see Figure 8).

\(^{33}\) Canada Post Annual Report 2013, p. 37.
In 2013, Canada Post released a "Five-Point Action Plan" to transform its business and to ensure financial sustainability by 2019. The most prominent discussed feature in the plan is to switch from door-to-door mail deliveries to the use of community mail boxes (in urban areas). After the federal election in 2015, the initiative has been halted as Canada Post decided to suspend this plan until it could reach some agreement with the new Liberal government.

On May 5, 2016, the Minister of Public Services and Procurement launched a review of the Canada Post Corporation. The objective of the review is to inform Canadians, Parliamentarians, and the Government about Canada Post Corporation’s financial situation, the needs of Canadians, and provide potential viable options to ensure that Canada Post provides quality services that meet the needs of Canadians at a reasonable price in a financially self-sustainable manner.

3.3 Conclusion

The Canadian approach to price regulation is fundamentally different from other countries as there is no genuine separation between the postal operator (Canada Post), the "regulator" (the Ministry), and the owner (the Ministry). Likewise, there is no independent regulator to control Canada Post.

Although a "crown corporation," Canada Post seems to be essentially an operational unit of the Ministry. Canada, in its postal regulatory framework, is thus similar to European countries prior to the Postal Directive (1997) or the United States prior to the establishment of the Postal Rate Commission (1970). As a result, Canada Post does not

Source: WIK-Consult based on Canada Post, Annual Reports.

35 Canada Post, Five-Point Action Plan – Our progress to date, March 2015.
have any commercial flexibility in its pricing decision but is restricted by political decisions as the Ministry makes all key strategic, commercial, and personnel decisions.

The revenues of Canada Post Segment, including all letter mail and parcel operations, remained relatively stable since 2007. This is due to the increasing revenues from parcels and on Canada Post’s price increases which almost entirely compensated for the constant letter mail volume decline since 2007. Between 2011 and 2013, Canada Post realized losses for three consecutive years but became profitable again after the introduction of a new tiered pricing structure for domestic stamped mail accompanied by a significant rate increase in 2014. There is only restricted transparency with regards to quality of service. The Postal Service Charter, issued in 2009, outlines the expectations concerning Canada Post’s service and only broadly covers universal service. In 2013, Canada Post started a further reduction of delivery quality by switching from door-to-door mail deliveries to the use of community mail boxes. However, this initiative that has been halted after the federal election in 2015.
4 France

4.1 Development of ex ante price regulation methods for mail services

In France, price cap regulation has been applied over the last ten years, but with some changes in the design of the price cap during the current price cap period. In addition to the price cap, French regulator Autorité De Régulation Des Communications Électroniques Et Des Postes (ARCEP) is entitled to decide on specific prices within the scope of the price cap if these prices do not comply with pricing principles for universal services. For example, ARCEP has made use of this right in its decision on prices for national universal service letters in 2014, demanding La Poste increase the price for the second weight step for priority letters less than proposed in its price proposal.

4.1.1 Services covered by price regulation

The scope of the price cap is very broad in France, and much broader than in the other countries analysed in this study (see Table 4). There is no public information on how much of the total volume is under the cap. However, we estimate the capped volumes to comprise at least 90 per cent of postal revenues in France. The price cap covers the whole universal service, including single piece tariffs as well as bulk services for business customers with or without pre-sorting requirements. Universal services are price regulated up to a weight of 2kg (~70.5oz), but lower weight thresholds apply to some business customer services. Addressed direct mail products including catalogues, press services and single piece parcels are also within the USO and thus subject to price cap regulation. In 2016, the scope of price regulation covered 50 products. The products within this scope have changed slightly over time due to the La Poste’s latitude to determine which bulk mail products are inside the scope of USO. This is legally determined by French postal law (R-1-1-10) and a special case among European postal incumbents. In 2014, the product ‘Minimax’ has been removed from the USO and the tracked letter has been introduced in order to simplify La Poste’s product structure.

The price cap applies to the whole basket of products, i.e. La Poste may set prices within the cap freely as long as the overall increases comply with the regulated scope for increases. Prices are thus not regulated individually, and some prices may increase more than others.

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39 For example, bulk priority letters are within the scope of universal service only up to 250g.
40 See La Poste (2016), Catalogue des offres commerciales de La Poste relevant du service universel postal, 1er mai 2016.
41 For example, La Poste has removed two advertising mail products from the USO in 2011 (“Courrier publicitaire Destino Intégral” and “Destino Catalogue Intégral”).
Table 4: Services covered by price cap (France)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Priority letters (D+1)</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>Economy letters (D+2)*</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Third class letters (D+3/4)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tracked letter</td>
<td></td>
<td></td>
<td></td>
<td>✔</td>
</tr>
<tr>
<td>Minimax (Small packets up to 2 cm thickness and 1 kg including basic insurance)</td>
<td>✔</td>
<td></td>
<td></td>
<td>✔</td>
</tr>
<tr>
<td>Addressed direct mail</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>Registered items and items of declared value</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Outbound international letters</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Press items within USO</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Universals service parcels (national and international outbound)</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>Re-direction national and int'l, Poste restante</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
</tbody>
</table>

Source: Based on price cap decisions of ARCEP.
Note: * Economy letters (D+2) exist since 2012.

4.1.2 Technical details of price regulation method

A price cap regime has been in place in France since 2006. Between 2006 to 2014, there were relatively few changes in the application of the price cap. In 2014, however, ARCEP decided on substantial changes in the methodology which were based on proposals by La Poste.

As background, letter volume declines in France have become stronger, while costs did not decline at the same pace.\(^{43}\) Due to the broad scope of price regulated services, La Poste did not have the commercial freedom to react with pricing measures. This had a negative effect on the financial situation of La Poste. According to French postal law, one of the things that price cap regulation has to take into account is the financial balance of the universal service obligation.\(^{44}\) Given the declining financial situation of La Poste, the objective to balance costs and revenues of the universal service obligation was not reached during the price cap period 2013-2015 due to La Poste’s volumes declining faster than expected. As a consequence, the price cap regime was revised in 2014. Details of the price cap regulation are provided in Table 5.


\(^{44}\) Code des Postes et Télécommunications, Article L 5-2.
Table 5  Details of price cap (France)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of years in price cap period</td>
<td>3</td>
<td>3 (4)</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Inflation p.a.</td>
<td>1.8%</td>
<td>2%</td>
<td>1.8%</td>
<td>1.7%</td>
</tr>
<tr>
<td>X-factor</td>
<td>-0.3%</td>
<td>-0.3%</td>
<td>-1%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Volume decline (included in x-factor)</td>
<td>-0.35%</td>
<td>-1.3%</td>
<td>-4.1%</td>
<td>-6.3%</td>
</tr>
<tr>
<td>Total scope for increase</td>
<td>2.1% p.a.</td>
<td>2.3% p.a.</td>
<td>2.8% p.a.</td>
<td></td>
</tr>
<tr>
<td>Subcaps?</td>
<td>No</td>
<td>Yes, services for business customers*</td>
<td>Yes, services for business customers**</td>
<td>No</td>
</tr>
<tr>
<td>Adjustment for real developments?</td>
<td>For inflation and real volume declines</td>
<td>For inflation and real volume declines</td>
<td>For inflation and real volume declines</td>
<td>For inflation and real volume declines</td>
</tr>
<tr>
<td>Application of price increases</td>
<td>50% of cumulated annual X-factors for all four years can be used in first year, 70%, 90% and 100% for following years.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: WIK-Consult based on ARCEP Price Cap Decisions.

Notes: * Includes until 2011: franking machine tariffs for priority and economy letters (prioritaire, ecopli) and franking tariffs for registered letters. In 2012, the subcap includes priority and economy letters as well as registered letters for business customers. ** Includes priority and economy letters for business customers.

While all price cap periods since 2006 had been limited to three years, the current period covers four years (2015-2018). The scope for price increases is determined by the inflation rate and an X-factor taking into account volume and cost developments.

Until 2014, the price cap formula denotes as \( dp/p = i - x \).

The X-factor is calculated as

\[ X = (i + \Delta q - \Delta c)/(1 + e) \]

where \( \Delta q \) = change in (economic)\(^{45}\) postal volumes and \( \Delta c \) = change of costs of La Poste (parent company). This means, if economic volumes and costs are stable, the X-factor compensates for the effect of inflation and there is no room for price increases. In case of economic volume decreases with increasing costs, the X-factor may become negative, increasing the scope for price increases. The term \( e \) expresses the price elasticity of demand and takes the value of -0.28.

\(^{45}\) Economic volumes are volumes weighted by price, corresponding to revenues.
The objective of the price cap regime is to set incentives to encourage efficiency while giving the regulated operator room for price increases. This is normally achieved by allowing price increases in line with inflation, diminished by an efficiency factor. In France, however, the X-factor did not have the effect of limiting the scope for price increases but has further enlarged it. ARCEP has justified this with volume declines and the problem of lowering costs commensurately.

For the price cap period 2015-2018, the formula was revised to \( \frac{dp}{p} = i + x \).\(^{46}\)

The detailed calculation of the X-factor has not been published by ARCEP since the end of 2009. But the X-factor increased substantially during the last price cap periods, reflecting the stronger decline of mail volumes (see Table 5).

The French price cap formula is based on forecasted developments of inflation and volumes. An adjustment factor takes account of real developments deviating from forecasts. In the price cap period 2015-2018, the adjustment factor has been adapted and became more sophisticated.\(^{47}\) The price cap uses a forecasted inflation rate and volume developments based on official statistics. During or after the second year of the price cap period, an adjustment can be made to account for differences between the forecasted and real data on request by either ARCEP or La Poste.

If realized inflation deviates from expected inflation by more than 0.5 percentage points, the X-factor is adjusted in the following year (n=2, 3 or 4) according to the formula given below, i.e. the difference between expected inflation \( i^e \) and realized inflation \( i^r \) is divided by 2 and the X-factor is adjusted by that result.

\[
\Delta x_2 = \frac{\Delta i_{n-1}}{2} \quad \text{if} \quad |\Delta i_{n-1}| > 0.5
\]

\[
\Delta i_{n-1} = i_{n-1}^r - i_{n-1}^e
\]

If realized volume developments deviate from expected developments\(^{48}\), 70 per cent of the difference (\( \Delta q_{n-1} \)) is taken into account for correction of the X-factor in the following year (n=2, 3, or 4) according to the formula given below. This mechanism limits the impact of differences between forecasts and reality on the price cap, thus taking into account the uncertain nature of forecasts.

\[
\Delta x_n = 0.7 \times \Delta q_{n-1}
\]

In addition to adjustments requested by either party, a review of the price cap decision after the first two years of the four-year period has been introduced. The review has been...

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\(^{46}\) The adjustment in the formula did not lead to substantial changes. In former price cap periods, the X-factor has always been negative, thus the application of the former formula lead to \( \frac{dp}{p} = i - (\cdot x) = i + x \).

\(^{47}\) The adjustment mechanism for the period 2015-2018 is described in ARCEP’s decision n° 2014-0841.

\(^{48}\) Expected developments refer to the -6.3 per cent annual decline ARCEP has forecasted.
It provides an overview of the adjustments carried out in 2016 when both inflation and volume development adjustments have been applied. While originally, the scope for price increases in 2017 had been 3.6 per cent, the adjustments due to lower inflation rate and higher volume declines than predicted limited the scope to 3.3 per cent in 2017. In addition, the scope for price increases in 2018 is determined.

In this price cap period (2015 to 2018), La Poste may increase prices higher than the average annual scope (3.5 per cent plus inflation, see table above) for the first time since price cap regulation in France. The relevant scope for price increases is now determined by a portion of the cumulated annual X-factors over the four year price cap period plus inflation for that year. ARCEP has defined a ‘consumption tunnel’ specifying which share of the cumulated X-factors La Poste may use in each year: up to 50 per cent in first year, up to 70 per cent in second, up to 90 per cent in third, and up to 100 per cent in fourth year (see Table 6).

<table>
<thead>
<tr>
<th>Table 6 Consumption tunnel</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of the cumulated X-factor available for price increases</td>
</tr>
<tr>
<td>50%</td>
</tr>
<tr>
<td>Capped price index in real terms (2014 = 100)</td>
</tr>
</tbody>
</table>

This consumption tunnel has been introduced in light of the length of the period (four years instead of three), and La Poste’s weak capacity to adapt its costs in line with volume decline. This mechanism results in high real term price increases during the first two years of the price cap period.

A subcap for business customer services is no longer applied in the 2015-2018 period. However, ARCEP separately reviews price developments of services intended for business customers within the price cap. It also has set the condition that prices for business customers may not increase more than prices for private customer services.

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52 ARCEP has approved an average increase of 7.5 per cent in 2015 and of 3.8 per cent in 2016 for the whole basket of services. See ARCEP (2015), Avis n° 2014-0846, p. 3 and ARCEP (2016), Avis n° 2015-0918, p. 3.
53 The distinction between business and private customers is made through the payment channel: services in the stamp channel and services outside the stamp channel. See ibid.
4.2 Key market developments

4.2.1 Prices and volumes

Prices for La Poste’s postal services have developed moderately in the period 2007-2013 with an average yearly increase of 2 to 3 per cent for most services (priority and non-priority letter services as well as parcels. During the last few years, however, prices for letters have increased substantially (see Figure 9). This was enabled through the enlarged scope for increases within the price cap. Priority stamps for the lowest weight step (20g) increased from 0.66€ in 2014 to 0.80€ in 2016, corresponding to an average annual increase of 10 per cent. Other priority weight steps increased stronger (e.g. 50g letters by ~21 per cent p.a.) while others even became cheaper (e.g. 100g letters, -1.5 per cent). Prices for parcels have become cheaper for most weight steps, e.g. the price of a 2kg parcel fell from 8.80€ in 2014 to 8.50€ in 2016. Addressed mail volumes fell by 27 per cent between 2007 and 2014.

Figure 9  Price and volume development in France (chain index: 2007=100)

Source: Wik-Consult based on price lists of La Poste.
Note: Annual prices as of end December. Price in 2016 as of late June.
4.2.2 Financial situation

La Poste lost 31 per cent of its volume between 2007 and 2015.\footnote{Calculation based on figures of ARCEP (2016), Observatoire annuel des activités postales en France, Année 2015.} The decline has been accelerating lately with an average annual loss of 5 per cent since 2010. The price increases have not been sufficient to compensate volume losses (see Figure 10): between 2007 and 2013, revenues of La Poste declined by 9.3 per cent. From 2014 on, mail revenues also include parcel revenues as a result of the new segmentation of La Poste group. As growing parcel revenues at least partly outweigh mail revenues losses, revenues in 2014 and 2015 cannot be compared to previous years.

Figure 10 Revenue and EBIT margin (France)

During the last decade, La Poste has been profitable. Yet EBIT margins have varied somewhat between 3 and 7 per cent. The EBIT of the mail segment had declined between 2011 and 2013 due to falling revenues. After restructuring the group, the EBIT of the now joint segment for mail and parcels recovered.

Source: WIK-Consult based on Annual Reports of La Poste.
Note: Parcel revenues include express. Since 2014, mail revenues also include parcels due to new segmentation.
4.2.3 Service quality

Transit time performance for both single piece and bulk mail has been relatively stable during the last ten years (see Figure 11). Transit times for single piece priority letters improved significantly since the beginning of the 21st century, when only about 70 per cent of priority letters were delivered the next working day. The improvement was achieved by investments in the infrastructure of the postal network and the modernization of mail sorting facilities.

Figure 11 Transit time (France)

Quality of services for business has been constantly above 90 per cent in each service category (D+2, D+4, D+7). French households receive delivery six days per week (Monday to Saturday), and this standard has not been subject to changes during the last decade.

The accessibility of postal services in France has been maintained on a high level. The total number of post offices has been stable since 2007. Today, the share of franchised Post Offices (agencies) situated in e.g. supermarkets or other stores is higher than in 2007: while only every third postal outlet was a franchised outlet in 2007, it has been nearly every second postal outlet in 2015 (45.8 per cent). The number of street letter boxes declined by one fifth between 2007 and 2015.

4.3 Conclusions

Volume declines of addressed mail volumes in France, and related revenue losses, required La Poste to react to these changing market conditions. La Poste’s potential to do so was, in principle, limited, as the scope of price regulated services is very broad in France and the company’s pricing decisions are restricted. However, the French regulator ARCEP has largely accepted La Poste’s price proposals in the past ten years, and granted price increases well above inflation due to the X-factor. ARCEP’s published price cap decisions show that it has generally followed the company’s line of arguments motivating the need for price increases.

The financial situation of La Poste was under pressure when volume decline accelerated during the last few years. However, declining EBIT margins in the mail segment may as well relate to a need for further modernization of postal infrastructure and operations.\footnote{See WIK-Consult (2013), Review of Postal Operator Efficiency, Study for Ofcom, November 2013.}

The pricing flexibility within the price cap has helped La Poste to compensate volume losses by price increases, at least in part. Overall, La Poste has been profitable in all years since 2007.

Except for a reduction of street letter boxes for collection (which also reflects of the changing demand patterns of household users), La Poste has not lowered its service...
standard.
5 Germany

5.1 Development of ex ante price regulation methods for mail services

Under the German Postal Law, operators require a license for the collection, forwarding, and delivery of addressed written communications, weighing less than 1,000g (~37oz.). There is a right for all operators that meet the specified requirements to obtain a license. The number of licences is not restricted and there are around 600 licensees active in the German postal market.\(^{58}\) The German Postal Law stipulates that all rates charged by a licensee in a market for postal services subject to licensing, require approval by the German regulator Bundesnetzagentur (BNetzA), provided the licensee has a dominant position in the relevant market.\(^{59}\) This approach aims to ensure that a dominant operator does not misuse its market position by establishing excessive tariffs or tariffs that are so low that competition is hindered. While in theory this could apply to other entities, in reality the regulation only applies to Deutsche Post, since it is the still the dominant player.

Price cap regulation was first applied in January 2003, and has been revised in 2008 and 2015. Additionally, prices that are not subject to ex ante approval are subject to ex-post review by BNetzA.

5.1.1 Services covered by price regulation

During the first price cap period, 2003 to 2008, all of Deutsche Post’s letter mail services subject to licensing were included in the price cap regulation with three baskets of combined services:\(^{60}\)

- **Basket M** (Monopoly Sector, i.e. reserved services) included standard letter services within the range of services reserved to Deutsche Post (i.e. letters up to 100g until 2006 and 50g as of 2006) and services without sufficient competitive pressure (e.g. large letters up to 500g);
- **Basket W** (Competition Sector) included all other letter services subject to licensing, i.e. up to 1,000g, not reserved to Deutsche Post; and
- **Basket T** (Partial Access to Services) for access products and worksharing rebates for services subject to licensing.

In 2008, the Deutsche Post’s exclusive rights expired and the German letter post market was fully opened to competition. The scope of ex ante price regulation was significantly

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\(^{58}\) Bundesnetzagentur (2016), Marktuntersuchung – Bericht über den lizenzpflichtigen Briefbereich 2015, p. 16.

\(^{59}\) Postgesetz (German Postal Law), §19.

\(^{60}\) Bundesnetzagentur (2002), Decision BK 1b-02-002, p. 11 sqq.
reduced by releasing bulk mail services of more than 50 items to ex post supervision. Since then, price cap regulation is limited to one basket which includes domestic single-piece items (stamped and franked) and international outbound letter services.\textsuperscript{61}

New services may be included in the price cap if they were provided for at least half a year in the relevant time period and by an entity with the dominant market position. Significant modifications of services are considered new products and included in the price cap accordingly. At the same time, services may be released from price cap regulation if they are no longer provided or due to cessation of the dominant market position for that service.\textsuperscript{62}

The price cap in Germany includes all single-piece products, but discounted products for commercial mailers are outside the price cap. In 2016, the price cap regulation included 19 domestic letter mail services and more than 20 cross-border services, including additional services such as registered mail or payments on delivery.\textsuperscript{63} Based on publicly available data, we estimate that these letter mail services represent a 10-20 per cent share of total letter volume.

5.1.2 Technical details of price regulation method

Pursuant to the German Postal Law, the BNetZA shall approve rates ex ante either on the basis of the costs of efficient service provision apportioned to the particular service (Single-Price-Procedure) or on the basis of productivity calculations it prescribes for the average rate of change for the prices of a basket of combined services (Price-Cap-Procedure). Since 2003, the Price-Cap-Procedure is applied to determine the annual increase in average weighted prices of the service basket(s) based on inflation and the projected increase in productivity (X-factor). Additionally, the price cap decision includes several auxiliary conditions; i.e., the obligation for Deutsche Post to annually report the number and locations of postal outlets, the transit times, and the number, locations, and pickup times of street letter boxes. The goal of this obligation is to monitor the quality of service. Deutsche Post is allowed to request adjustments of its tariffs at any time, and BNetZA has to assess the compliance with the price path each year. Table 7 below summarizes the parameters of BNetZA price cap decisions since 2003.

\textsuperscript{61} Bundesnetzagentur (2007), Decision BK 5b-07/068, p. 8 sqq.
\textsuperscript{62} Bundesnetzagentur (2002), Decision Bk1b-02-002, p. 1 sqq.
\textsuperscript{63} Bundesnetzagentur (2015), Decision BK5-15-042 Anlage 1.
### Table 7: Details of price cap (Germany)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of price cap periods</td>
<td>5 one-year periods</td>
<td>4 one-year periods</td>
<td>2 one-year periods</td>
<td>5 one-year periods</td>
<td>1 three-year period</td>
</tr>
<tr>
<td><strong>Inflation</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003: 2.0%</td>
<td>2008: 1.5%</td>
<td>2012: 1.8%</td>
<td>2014: 1.4%</td>
<td>2016-2018: 1.7%</td>
<td></td>
</tr>
<tr>
<td>2004: 1.4%</td>
<td>2009: 0.6%</td>
<td>2015: 0.6%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005: 1.1%</td>
<td>2010: 2.6%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006: 1.6%</td>
<td>2011: 0.3%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007: 1.6%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>X-factor</strong>*</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003: Basket M: 7.2%</td>
<td>1.8% p.a.</td>
<td>0.6% p.a.</td>
<td>0.2% p.a.</td>
<td>2016-2018: -5.8% total</td>
<td></td>
</tr>
<tr>
<td>Basket W: 1.8%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basket T: 6.5%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004-2007: 1.8% p.a. for all baskets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Volume decline (included in X-factor)</strong></td>
<td>No</td>
<td>No</td>
<td>Confidential</td>
<td>Confidential</td>
<td>Confidential</td>
</tr>
<tr>
<td><strong>Total scope for increase</strong></td>
<td>October 2003: M: -5.2%</td>
<td>2008: -0.3%</td>
<td>2012: 1.2%</td>
<td>2014: 1.2%</td>
<td>2016-2018: 7.5% total</td>
</tr>
<tr>
<td>W: -0.2%</td>
<td>2009: 0.7%</td>
<td>2013: 0.9%</td>
<td>2015: 0.4%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>T: -4.5%</td>
<td>2010: 0.8%</td>
<td>2016: 0.4%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004: -0.4%</td>
<td>2011: -1.5%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005: -0.7%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006: -0.2%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007: -0.2%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Adjustment for real developments?</strong></td>
<td>For inflation only</td>
<td>For inflation only</td>
<td>For inflation only</td>
<td>For inflation only</td>
<td>For inflation only</td>
</tr>
<tr>
<td><strong>Application of price increases</strong></td>
<td>Deutsche Post may request changes in tariffs and carry over price increases not applied in previous price cap periods</td>
<td></td>
<td></td>
<td></td>
<td>100% in 2016</td>
</tr>
</tbody>
</table>

Source: WIK-Consult based on BNetzA Price Cap Decisions, Destatis.
Notes: * In the first price period (2003-2007), three baskets (M: Monopoly Sector, W: Competition Sector, T: Partial Access to Services) were applied with individual x-factors for the first year.
** The price cap 2014-2018 was repealed in 2015 due to a change in postal legislation, and replaced by a new decision.

The price cap decision (“Maßgrößenverfahren”) determines the price path, i.e. the allowed annual price changes based on the initial cost level, the inflation, and the expected productivity changes. Since 2003, the price path up to five years is derived from the following price cap formula: 64

\[
\frac{\sum_{i=1}^{n} q_{i,t-2} \cdot p_{t-1}}{\sum_{i=1}^{n} q_{i,t-2} \cdot p_{i,t-1}} \leq t_{t-2} - X_t + \Delta_t
\]

The left hand side represents the increase in average weighted prices of the service basket which is applied as the starting basis (according to the principle of Laspeyres indices) with \( t \) as year of tariff approval, \( t-1 \) the tariffs in the previous year, \( i \) as index

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64 Bundesnetzagentur (2002), Decision Bk1b-02-002, p. 4.
and n as total number of services in the basket, $p_{i,t}$ as proposed tariff of service $i$, and $q_{i,t-2}$ as sales volume of service $i$ in the reference period. The right hand side determines the maximum allowed increase in average weighted prices determined by inflation $l_{t-2}$ in the reference period, the projected increase in productivity (X-factor) $X_t$ and the allowed carry over $\Delta_t$.

The inflation parameter $I$ is based on the consumer price index of the German Statistical Office Destatis. Initially, the year prior to the decision was used as reference period for the customer price index. For example, in its 2007 decision on allowed price increases for the year 2008, the BNetzA used the increase in customer prices in 2006. In the price cap period 2012-2013, the reference period was brought forward ($l_{t-1.5}$): since then the inflation is calculated as arithmetic mean inflation between July and June, e.g. the calculation for 2012 was based on the inflation between July 2010 and June 2011.

The allowed carry over, $\Delta_t$, is the unused scope of annual tariff increases or annual price reductions exceeding the requirements in previous years. This is intended to provide Deutsche Post pricing flexibility and reduce transaction costs, e.g. for the annual issuing of new stamps. In the recent price cap decision, BNetzA decided to implement one price cap period, i.e. Deutsche Post was allowed to increase their prices once in 2016 and obliged to keep prices stable for three years which implies that there will be no carry over in 2017 and 2018.

The X-factor provides the projected increase in productivity or the efficiency target. The German postal rate regulation ordinance (Post-Entgeltregulierungverordnung, PEntgV) specifies that the determination of the expected rate of growth in productivity shall take into account (i) the cost of the efficient provision of services including so-called “neutral expenses” and (ii) the productivity growth rates of undertakings in comparable competitive markets. Consequently, the X-factor considers two distinct factors:

1. the gap between the initial rate level and the cost of efficient provision; i.e. rates are aligned with projected unit costs. Most visibly, in the first price cap decision, a particularly high X-factor was applied in the first year to bring prices down to cost levels, and thus reduce an excessive price level at the time (X-factor was 7.2% for 2003).

2. the expected productivity changes during the years within the price-cap periods by reviewing the cost base and related cost forecasts.

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66 Bundesnetzagentur (2011), Decision BK5b-11-017, p. 38 sqq.
67 Bundesnetzagentur (2002), Decision BK1b-02-002, p. 25.
68 Neutral expenses, as defined in the German Postal Act, are additional expenses for Deutsche Post AG arising from legal obligations; for example, the nationwide infrastructure for the provision of universal postal service, social costs, and pension fund reserves resulting from the past as state-owned enterprise.
69 Postentgeltverordnung, §3.
The latter issue considers the potential for improving the productivity by rationalization and optimization of operational procedures as well as the potential impacts of mail volume decline on productivity and unit cost.

In its 2011 price cap decision, BNetzA acknowledged the structural change in the letter mail market and potential volume decline by rejecting Deutsche Post’s request to adopt a term of four years as in previous price caps. The BNetzA concluded that data on letter volume developments did not corroborate Deutsche Post’s thesis that volumes would decrease massively. Given uncertainties on future volume developments, BNetzA shortened the duration of the price cap regulation in order to be able to reassess the price cap decision after two years to allow them to incorporate more recent information on volume developments.\(^70\)

In its 2013 decision, BNetzA concluded that the increase in average costs by expected volume decline is overcompensated by cost savings from efficiency gains. BNetzA decided to implement a positive X-factor, i.e. allowing the basket tariffs to increase less than the inflation rate. Further, BNetzA decided to return to a price cap period of five years but noted the opportunity to revise the price cap regulation in the case of significant acceleration of letter volume decline.\(^71\)

In 2015, BNetzA had to revise its previous price cap decision due to a change in the postal rate regulation ordinance (PEntgV): the basis for calculating the profit margin (as part of the cost of efficient provision) were changed to return on sales instead of return on assets. Despite the technical nature of the legal change (and the various facets of the options for determining allowed profits that could be discussed by economists), the political objective clearly was to increase the level of allowed profits for Deutsche Post in times of declining volumes, and more uncertainties in postal operations. In addition to broadening the basis to which allowed profit margins apply (revenues significantly exceed assets in Deutsche Post’s regulated business), the new legislation introduced in 2015 specifically called on regulator Bundesnetzagentur to use international, benchmarking in determining reasonable profits. The review resulted in a negative X-factor (\(-5.8\) per cent) which allowed for a much higher scope for price increases in 2016. The price cap is applied for one period of three years and obliges Deutsche Post to keep prices stable until the end of 2018.\(^72\)

\(^70\) Bundesnetzagentur (2011), Decision BK5b-11-017, p. 43-44.
\(^71\) Bundesnetzagentur (2013), Decision BK5b-13-001, p. 34-35, p. 43-44.
\(^72\) Bundesnetzagentur (2015), Decision BK5-15-012.
5.2 Key market developments

5.2.1 Prices and volumes

Since the introduction of the Price Cap regulation and the initial price decreases during the first price cap period from 2003 to 2007, the single-piece prices of Deutsche Post have been stable for a long period with only moderate increases for international letters. In 2013, national prices for the lowest weight step (20g) increased for the first time in more than ten years. Since then, there have been annual price increases for the lowest weight step, but higher weight steps such as the 500g letter have remained stable. Overall, Deutsche Post has increased its prices only slightly compared to operators in other European countries (see sections on France and UK). The reasons are two-fold: first, the level of stamp prices has been relatively high at the beginning of the millennium compared to other countries, and the long period of stable prices contributed to bring the price level more in line with other countries. Second, Deutsche Post did not have to suffer from substantial volume declines. On average, addressed letter volumes fell by only 2.5 per cent per year between 2007 and 2015.

Figure 13  Price and volume development in Germany (chain index: 2007=100)

![Price and volume development in Germany](image)

Source: WIK-Consult based on Deutsche Post, Price lists.
Note: Annual prices as of end December. Price in 2016 as of end June.

73 See WIK-Consult (2003), Main Developments in the European Postal Sector, Study for the European Commission, DG Internal Market, p. 145.

74 Calculation based on market observation reports of Federal Network Agency.
5.2.2 Financial situation

Deutsche Post’s mail revenues are quite stable since 2007 (see Figure 14 below). This indicates that the low letter mail volume decline has been almost entirely offset by the moderate price increases in recent years. Deutsche Post’s mail division was the major source of the company’s profits until 2010 and still is a very profitable business. The EBIT margin of the parent company Deutsche Post AG, which letter mail services account for around 70 per cent of its operations and business, has fallen during the economic crisis but has remained on a high level since 2010.

Figure 14 Revenue and EBIT margin (Germany)

Source: Wik-Consult based on Deutsche Post, Annual Reports and Annual Financial Statements (HGB).

Notes:
* EBIT margin, revenues and OPEX refer to the parent company (letter mail accounts for 70 per cent of its business).
** Revenues (mail services) refer to letter mail services of the parent company (Deutsche Post AG).
*** EBIT margin (Group) refers to Deutsche Post DHL Group.

5.2.3 Service quality

In Germany, there is a relatively low quality target for single piece mail: 80 per cent of single-piece letters (bulk letters are not taken into account) have to be delivered on the next working day. Figure 15 illustrates that Deutsche Post has exceeded this target.

75 The change in the financial result in 2015 is mainly due an intragroup transfer of investments and profits. See Deutsche Post (2015), Annual Financial Statements HGB, p. 37.
regularly during the last ten years with transit times well above 90 per cent. Yet for the last available year (2015), Deutsche Post reports a slight decline of its transit time.

Figure 15 Transit time (Germany)

Source: Based on Deutsche Post, Annual Reports.

Access points of Deutsche Post have remained stable since 2007 (see Figure 16). For postal outlets, even a slight increase can be observed due to the increasing demand for parcel pick-up and return points. All Deutsche Post’s post offices were replaced by partner outlets by 2010.\textsuperscript{76} There has been no significant change in the number of street letter boxes in the last decade with around 110,000 boxes throughout the country in 2015. In January 2016, Deutsche Post announced plans to reduce the number street letter boxes with Sunday collection from 11,000 to 2,000 (i.e. from 10 to 2 per cent).

\textsuperscript{76} Except two: one at the headquarter of Deutsche Post in Bonn and one at Parliament, the German Bundestag, in Berlin.
5.3 Conclusions

In Germany, only single-piece items up to 1,000g are subject to ex ante approval by means of a price cap regulation. This provides Deutsche Post with a high degree of commercial flexibility. In contrast to other postal operators, Deutsche Post’s single-piece tariffs have been subject to a positive X-factor until 2015, allowing basket tariffs to increase less than inflation. The German regulator justified the positive X-factor with the expectation that the increase in average costs from expected volume decline is overcompensated by cost savings from efficiency gains. In the last price cap decision (for the period 2016-2018) the basis for calculating the profit margin has changed due to change in postal legislation, introduced to allow higher profit margins for Deutsche Post. The review resulted in a negative X-factor and a much higher scope of allowable price increases for Deutsche Post.

In contrast to other postal operators, Deutsche Post has faced relatively stable letter mail volumes in the last decade: addressed letter mail volume declined by only 2.5 per cent p.a. on average between 2007 and 2015. Domestic single-piece tariffs for Deutsche Post have been stable until 2013. Since then, there have been annual price increases for the lowest weight step (20g), but higher weight steps have remained stable. The revenue development of Deutsche Post’s mail segment indicates that the moderate price increases almost entirely offset letter mail volume decline. The mail division was the major source of Deutsche Post’s profits until 2010 and still is a very profitable business with an EBIT margin of around 8 per cent. Deutsche Post’s quality in terms of transit time and accessibility of postal services remained stable during the last decade, exceeding the statutory requirements.
6 United Kingdom

6.1 Development of ex ante price regulation methods for mail services

The last ten years of ex ante price regulation in the UK have been marked by a fundamental shift in the postal regulatory approach, coinciding with a change of the postal regulator. While the overall goal of UK postal regulation has not been touched – to secure the provision of the universal service – the method has changed from a strict regulatory control to a more light-handed approach. In light of the weak financial performance of Royal Mail in the years prior to 2012 as well of changing market conditions, the regulator decided to grant Royal Mail more commercial flexibility to enable it to provide a financially viable universal service. At the same time, Ofcom emphasized the need to improve efficiency and secure consumer protection. The new regulatory framework, which will be in place for a period of seven years, is designed to achieve these goals.

6.1.1 Services covered by price regulation

Prior to 2012, the scope of ex ante price regulation was very broad and covered about 89 per cent of letter volumes. Since 2012, only a minority of letter volumes is subject to ex ante price control. In financial year 2015-2016, about 23 per cent of Royal Mail's addressed letters were inside the scope of USO. However, not all universal services are price-controlled, pushing the share of price-controlled letters below 23 per cent.

Under the 2012 regulatory regime, all price controls for universal services are lifted except for single-piece second class services. As a consequence, there is no ex ante control on first class services, and Royal Mail may set prices freely. To prevent Royal Mail from increasing prices while not enforcing its efforts to improve efficiency, Ofcom has put in place three safeguards:
1. a monitoring regime
2. a cap on the prices for second class stamps
3. access regulation

The monitoring regime will closely observe Royal Mail's performance. In addition to financial performance, it also covers indicators for universal service, efficiency, pricing, and competition.

The cap established on second class services is a safeguard cap meant to ensure affordable services for vulnerable consumer groups. The safeguard cap covers prices for
International Price Regulation

second class letters up to a weight of 2 kg. Heavier items are not covered by the cap as there is sufficient competition in the parcel market, enabling consumers to choose between a range of operators for sending items above 2 kg. Details of the cap are provided in the next section.

Access regulation is maintained with the goal to ensure competition in the upstream part of the mail market. Although Ofcom does not directly regulate access prices, it carries out a margin squeeze test to ensure that the upstream share of Royal Mail’s revenues covers the relevant costs. The objective is to ensure Royal Mail’s access prices are not below costs, which would enable Royal Mail to push competitors out of the market.

6.1.2 Technical details of price regulation method

While priority letter services are not subject to ex ante price regulation anymore, non-priority services are subject to a so-called ‘safeguard cap’. The safeguard cap on second class letters introduced in 2012 allowed Royal Mail to strongly increase prices of second class letters (see also section on price development 6.2.1). The cap takes the form of a price limit set at 55p in 2012 for standard letters in the lowest weight step (100g, see Table 8). This limit refers to an increase of about 53 per cent compared to the 2011 price of 36p. The limit may develop in line with consumers’ prices during the period of the regulatory framework of seven years. For large letters and parcels (weighing more than 100g or in non-standard format), a basket is created containing the weighted average prices for all weight steps up to 2 kg. This basket may increase by also 53 per cent relative to 2011-2012 prices, and then increase by CPI each year. The prices are weighted by actual volumes for each price step. The volumes relate to the year prior to the calculation of prices, i.e. a two-year lag in volume development is accepted. Royal Mail may set its prices freely within the basket and even change the structure of its tariff grid.

The intention of the safeguard cap was to ensure consumers have access to affordable postal services, in particular vulnerable consumers (e.g. elderly people, inhabitants of rural and remote areas, people with reduced mobility). However, due to the generally low share of postal spending in consumers’ budgets, the safeguard cap would allow even substantial price increases without violating the affordability criterion.

Table 8  
Safeguard cap for second class services (UK)

<table>
<thead>
<tr>
<th>Price step</th>
<th>Scope for price increases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard letter (100g)</td>
<td>55p (2012; total price)</td>
</tr>
<tr>
<td>Large letters and parcels (up to 2kg)</td>
<td>53% compared to 2011-2012 prices</td>
</tr>
</tbody>
</table>


Note: Maximum dimensions of large letters are 35.3 cm (~14 inches) in length, 25 cm (~10 inches) in width, and 2.5 cm (~1 inch) in thickness. Maximum weight of large letters is 750g (~26.5 oz).

In order to maintain a financially viable universal service, Ofcom decided Royal Mail should be allowed to earn a reasonable rate of return. However, a reasonable rate of return is not a part of price regulation. Ofcom considers an EBIT margin between five and ten per cent as appropriate, and will monitor the financial performance of Royal Mail as part of the monitoring regime. The current EBIT margin of Royal is at the lower end of this range (see Section 6.2.2).

The period for regulatory framework, and thus also for the safeguard cap, was set at seven years. This quite lengthy period was chosen to grant regulatory certainty to Royal Mail and other stakeholders, and to give Royal Mail time to realize efficiency improvements. However, Ofcom recognized the risk that Royal Mail might use its new commercial flexibility to raise prices instead of increasing efficiency as expected, and could possibly react in a way that would not support the regulatory objectives. In that case, or in case of significant unanticipated market challenges, Ofcom had, in its 2012 statement, established the option to re-open the decision. In 2015, Ofcom decided to review the regulatory framework in light of new market developments, in particular the withdrawal of the only competitor Whistl from providing end-to-end services, as well as to assess Royal Mail’s efficiency and its position on the parcel market. Although a final decision is outstanding, Ofcom has recently proposed to maintain the current regulatory framework until 2022, and also to retain the safeguard cap. The regulator is currently seeking the views of stakeholders on its proposals and plans to issue a final decision before the end of the regulatory period (end of March 2017).

87 Ofcom (2016), Review of the Regulation of Royal Mail, Consultation of 25 May 2016.
6.2 Key market developments

6.2.1 Prices and volumes

During the last decade, price increases have been strong both in first and second class. The stamp price for the lowest weight step (100g) has increased by 88.2 per cent in first class and more than doubled (129.2 per cent) in second class between 2007 and 2016 (see Figure 17). After a period of rather moderate increases until 2011, prices have jumped to a significantly higher level in 2012 in the context of the release of first class letters from price control and the introduction of a safeguard cap for second class letters. After that date, price increased modestly, and prices for small parcels have even decreased.

Figure 17 Price and volume development in the UK (chain index: 2007=100)

Source: WIK-Consult based on Royal Mail price lists.
Note: Annual prices as of end December. Price in 2016 as of end June.

6.2.2 Financial situation

During the last ten years, Royal Mail has gone through financially difficult times, in particular at the beginning of that period. Lately, revenues have increased, mainly due to increasing parcel volumes. As price increases have compensated for volume declines, revenues for addressed letters (including first and second class products) have remained relatively stable (-0.6 per cent on average per year between 2011 and 2015). EBIT
Margins in the mail and parcel segment UKPIL have also reached a higher level from 2012 on, but declined recently from 7.1 (2013) to 4.6 per cent (2015).

Figure 18 Revenue and EBIT margin (UK)

![Graph showing revenue and EBIT margin (UK)](image)

Source: Wik-Consult based on Royal Mail, Annual Reports.

6.2.3 Service quality

Service quality is also part of the monitoring regime established by Ofcom. Royal Mail has to meet a number of service targets, of which the three main relate to routing time of priority and non-priority postal services. Of all first class letters and parcels, Royal Mail has to deliver at least 93 per cent the next day after posting (D+1), and 91.5 per cent in each Postcode Area the day after posting. For second class, 98.5 per cent have to be delivered with a D+3 routing time.

While the general trend shows that quality of service for first class mail has improved over the last ten years, Royal Mail has not achieved its target in a number of years (see Figure 19). This becomes even more obvious if the quality of service is shown by how many postcodes in which it is meeting the standard, as shown on the right of Figure 19. However, it has to be taken into account that the result for 2007 was affected by national strikes as well as local industrial action.

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88 DUSP 1 (Designated Universal Service Provider Condition 1), Condition 1.6.1.
Figure 19  Transit time (UK)

Source: Wik-Consult based on Ofcom, Royal Mail, Annual Reports and Quarterly Quality of Service Reports.

Note: Royal Mail has to deliver 91.5% on the next day in 118 of 121 postcode areas.

For second class mail, Royal Mail has performed better: the target has been met since 2011, and performance was achieved more than 95 per cent of the time during the last ten years.89

Figure 20  Access points (UK)

Source: Wik-Consult based on UPU Postal Statistics and Post Office Network Reports.

Traditionally, the great majority of access points in the UK are operated by sub-postmasters which are agency contract partners of the Post Office Ltd. Although Post Office Ltd. is a separate corporate entity, access points operated by employees of the Post Office (the so-called ‘Crown Post Offices’) are treated as own post offices here due to the nature of the contract between the postmaster and Post Office Ltd. The number of street letter boxes has remained stable overall.

89 See Royal Mail, Quarterly Quality of Service Reports.
6.3 Conclusions

After a period of tight regulatory control by its former regulator (Postcomm, the Postal Services Commission), the new regulatory authority Ofcom introduced a more flexible price cap regime in 2012. Royal Mail now has very substantial commercial flexibility, including pricing flexibility, restricted only by a safeguard cap on its second class letters and large letters to protect vulnerable customers.

Royal Mail has clearly benefited from the new regime. While letter volumes continued to decline, revenues stabilized as a result of price increases. EBIT margins both for the mail and parcel segment UKPIL as well as for the group as a whole increased and are now on a much higher level than prior to 2012. In spite of difficult market conditions, Royal Mail has achieved stable quality results in terms of transit time and reduction of postal outlets has been kept to a minimum.

However, the improvements of Royal Mail’s financial situation have not been the result of a new regulatory approach alone. Comprehensive modernization of postal operations and efficiency programs started in 2008/2009, and the effects of these investments have also played an important role in improving financial results.

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Appendix B: Management's Comments

Lessons in Price Regulation from International Posts
Report Number RARC-WP-17-003

THOMAS J. MARSHALL
GENERAL COUNSEL
AND EXECUTIVE VICE PRESIDENT

UNITED STATES POSTAL SERVICE

February 2, 2017

RENEE SHEEHY
DIRECTOR, RARC CENTRAL

SUBJECT: Final Review Draft – Lessons in Price Regulation from International Posts
(Project Number 2016RARC016)

Thank you for the opportunity to review the report entitled Lessons in Price Regulation from International Posts. The report is a helpful analysis of the regulatory systems governing other posts, and is particularly timely considering the Postal Service’s regulatory system for market-dominant products is currently being reviewed by the Postal Regulatory Commission. We appreciate OIG’s efforts in analyzing this issue.

We only have one comment for your consideration. In particular, the report at page 9 speculates about possible causes behind the international posts “success at maintaining service levels.” While the report does not offer any evidence to support one hypothesis or another, we are dubious that the reference to regulatory enforcement measures is accurate. Among the surveyed postal systems, we are aware of only one (the U.K.) as having any history of providing financial incentives for achieving service goals, but the current postal regulator abolished that mechanism in 2012, finding that it had been ineffective. Therefore, we consider the alternative hypotheses to be more likely: price increases have provided adequate revenue for the postal operators to ensure high quality service, and/or service standards are designed in a way that they have been consistently achieved. For instance, we consider the link between adequate revenues and the ability to maintain quality service to be self-evident. We also note that at least two of the surveyed countries (the U.K. and Australia) have divided their basic letter service (the equivalent of the Postal Service’s First-Class Mail) into two classes of service, thereby using their product and pricing flexibility to incentivize customers to select a service level that is both less costly and more achievable for the postal operator.

We do not believe any portion of this draft paper may be exempt from disclosure to the public under the Freedom of Information Act (FOIA).

Again, thank you for the opportunity to comment. Please let us know if you have any questions or concerns.

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