



# Europe Economics Executive Briefing

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## Community harmonisation and the shape of next Postal Directive

*As we approach the next round of negotiations over EU postal regulation, the appropriate level of Community harmonisation of postal regulation remains a key issue.*

### Introduction

The debate over the next stage of the development of European postal regulation has begun.

This debate will revolve around liberalisation issues and also around the definition of regulatory principles and the balance between Community regulatory harmonisation and national subsidiarity.<sup>1</sup>

### Background

The background to this debate is that, until now, the level of Community harmonisation in postal regulation has been fairly light, with key regulatory principles such as those governing pricing and universal service obligations, set at a general, or Community minimum, level.

Reflecting the reluctance of some Member States to cede control over this politically sensitive sector, this lack of definition has allowed for different national approaches to postal regulation.

In practice this divergence of approach does not always sit easily with the development of an internal market for postal services. Effective competition across and within the Member States implies similar regulatory conditions. Otherwise differential regulatory

treatment may, in theory, provide incentives for some market players, enjoying relative regulatory protection, to extract rents or seek to cross — subsidise their activities that are most open to competition.

### A framework definition of key postal regulatory principles

As a Service of General Economic Interest, the framework of postal service regulation reflects the basic principles of Articles 82 and 86 of the Treaty, in that any regulatory protection of the incumbent Universal Service Provider (USP) should be no more than that necessary to compensate for any net burden imposed by universal service provision. In line with Article 86.2, the USPs are subject to competition rules, "insofar as the application of such rules does not obstruct the performance, in law or in fact of the particular tasks assigned to them".

In this context, it can be argued that a lack of clarity in the Community regulatory framework may lead to an increased reliance by market players on competition law mechanisms to secure fair competition.

Problems of general regulatory definition occur both due to regulatory asymmetry (as previously described), and also due to legal uncertainty.

This becomes clear in a brief review of the key postal regulatory principles.

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<sup>1</sup> For an overview of competition in the EU postal sector, see "The Birth of the New European Postal Market" available on our website, March 2005.



## The universal postal service

Perhaps the most important single definition is that of the entitlement of EU citizens for a universal postal service. In one sense, this Community entitlement forms the solid core around which the rest of the postal services market can take shape.

It is important, not least in that each element of the service, once defined, constitutes a potential block on alternative market provision, for example in that the USP can seek regulatory compensation protection for any losses made.

The universal postal service defined in the Amended Postal Directive involves three key components:

- At least once daily collection and (home or premises) delivery every working day on not less than five days a week
- A universal service product range including postal items up to two kilograms and postal packages weighing up to ten kilograms for domestic packages and up to twenty kilograms for cross border packages.
- Access to a universal service postal infrastructure involving the collection, sorting, transport and delivery of above said postal items and packages at a level of density that takes accounts of the needs of users.

In each of these areas fairly general definition has allowed for different universal service conditions in practice, and, therefore, the level of regulatory intervention set by the universal service obligation has varied in the Member States.

For example, the service specification requirements do not include domestic

quality of service targets, which are left to national regulatory judgement. These targets may in practice be significant cost drivers and affect the 'cost of the universal service.'<sup>2</sup> and the pattern of the necessary universal service infrastructure.

Further, the product range that comprises the universal service remains largely undefined at Community level.

Again, this is not a 'market-neutral' issue, as the range of products chosen to be within the universal service will affect the scale of regulatory intervention.

Intuitively, a narrower universal service product definition should generally represent a reduction in the level of regulatory intervention. For example, a 'reducing' definition of universal services may allow USPs to discontinue their provision of loss-making and unpopular products and, logically, may reduce the scope of products for which the USP may be obliged to maintain a geographically averaged uniform tariff. In doing so, a reducing definition should act to limit the scale of obligation associated with universal service provision.

If this obligation or net burden was assessed by a Net Avoided Cost approach, identifying and aggregating all the elements of loss<sup>3</sup> in the service provision, a narrower scope may produce fewer identifiable losses.

However, alternatively, if it is thought that only 'universal services' have to bear all the

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<sup>2</sup> For example Postcomm in its recent Price control consultation has suggested that it is minded to increase the current the 'C factor' quality of service performance incentive of £30m.

<sup>3</sup> Calculated on the basis of incremental or avoidable costs.



costs of the universal service infrastructure<sup>4</sup>, then a narrower range of services may increase the apparent burden of universal service provision.

In any case, this product definition has become increasingly controversial. Initially NRAs tended to equate universal service products with the current provision of their USP and shied away from a more detailed definition. However, more recently regulators and USPs in the UK, Netherlands and Ireland have debated what 'universal service' really means, moving towards greater clarity and precision in their national regulation.

There has been some vigorous national debate over the third of the components; the definition of the scope of the universal service infrastructure. This has focused on the provision of (especially rural) post offices and on issues connected to access to universal services for consumers via post offices parcels counters and the availability of collection points.

However, it can also be argued that the appropriate scope and organisation of the universal service infrastructure is a rather unexplored issue in postal services regulation. Whereas telecoms regulators have used 'scorched — node' techniques to push for greater rationalisation of provision, for example, in price control negotiations, postal regulators have generally preferred more gentle approaches to press for greater efficiency while avoiding direct restructuring instructions.<sup>5</sup> Rather they have considered the universal service infrastructure largely to be that which is already provided by the

national USP rather than one that should be modelled outwards from universal service requirements and the typical inputs required.

## **Pricing and accounting principles**

Pricing and accounting principles have also been defined at a fairly general level in the Community framework, and reflect primarily competition law imperatives.

The Amended Postal Directive requires prices that are 'geared to cost', non-discriminatory and transparent. Access prices have to 'take account' of avoided costs and universal service prices also have to be 'affordable'.

Cross subsidisation (or pricing below incremental cost) is not permissible for non-reserved non-universal service products and there has to be an accounting separation for reserved and non-reserved and non-reserved universal and non-universal services, with the requirement also for the full distribution of costs in the accounting and pricing of services.

In practice these general principles again allow for some variety of application.

'Geared to cost' is a vague concept and the revised Article 12 appears neutral over possible regulatory approaches, for example, in relation to access price calculations.

Further, there is no detailed Community harmonisation on the application of pricing principles in key areas such as uniform tariff requirements (which are not required at Community level), the scope for pricing flexibility for the USP and the level of scrutiny and permissibility of discounting

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<sup>4</sup> For example, the Incremental Cost Test once promoted by DG Competition seems to point in this direction.

<sup>5</sup> An exception here may be Comreg's document, "Regulation of Postal Services Universal Service Obligation- Bulk Mail Access."



procedures, beyond competition law imperatives.

Accounting separation has also varied between the Member States, reflecting in part different approaches to the introduction to competition into the market.

Licensed introduction of competition arguably creates new 'non reserved services' with each new licence, making an accounting split, as according to Article 14 difficult and, therefore, further complicating the enforcement of competition law.

### **The role of the National Regulators (NRAs)**

Another source of variance is the lack of definition in the role and remits of national regulators (NRAs).

Article 22 of the Amended Postal Directive requires that Member States must "designate one or more national regulatory authorities for the postal sector that are legally separate from and operationally independent of the postal operators",

This has led to a variety of organisational models with postal regulators ranging from fairly large autonomous bodies such as in the UK, to postal regulatory teams within a broader Communications regulator which includes telecoms regulation, to postal regulatory teams within a Ministry, which is separate from that which controls the USP.

In this sense, again, the individual arrangements for setting up national postal regulators have reflected different national visions for postal services and different traditions of regulatory practice. Different models have also been combined with different levels of resources and of focus on postal regulation.

Different remits for the NRAs also create different approaches. For example, a key difference may be between regulators which are charged with the promotion of competition in the sector and those which are not.

### **VAT**

The remaining lack of harmonisation over the application of VAT in the sector could also pose a significant barrier to the internal market, providing possible advantages to some USPs but not others.

### **The lack of clear market definitions**

There are also some problems associated with the Community framework's market definitions.

As postal operators have moved into upstream and downstream operations it has become more difficult to judge whether their activities are 'postal' or not, for instance where the collection of mail begins and mail preparation ends.

Further, some of the definitions in the Postal Directive such as that in Article 2.6, which appears to restrict the definition of 'postal items', to those carried by the USP are potentially confusing and seem inconsistent with other EC positions.<sup>6</sup>

In other areas the lack of a clear market definition has created legal uncertainty for example in the case of the definition of "special services"<sup>7</sup>

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<sup>6</sup> For example the EC GATS classification.

<sup>7</sup> This of course raises also the whole question of the appropriate regulatory treatment of express services which should perhaps be the topic of a different paper.



## Conclusions

It is clear that the postal market is at a critical stage in its development as it embraces dynamic structural change with the move towards the competitive mail market and the privatisation of USPs. At this vital stage, to avoid serious market distortions, regulatory development should be consistent with, and facilitate, market development.

In this respect, it can be argued that only through greater harmonisation of regulation can the Community framework best allow for market development. Such harmonisation may foster more consistent regulatory approaches and prevent the emergence of national regulatory border effects.

However, the best way to shape any greater harmonisation is open to debate. The Treaty requires that in achieving the right balance between Community and national regulation the fundamental principle of subsidiarity should apply, which is that that the Community shall take action "only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community".<sup>8</sup>

In this respect, it may not be appropriate, for example, to simply translate harmonised regulatory approaches into the European legal context. Rather, it may be better to seek an appropriate balance, which further meets internal market imperatives and removes market distortions, whilst continuing to allow the Member States appropriate discretion in pursuing national visions for postal services.

For example, it can be argued that there is scope for varied universal service definitions, provided they do not impose unnecessary burdens which could foreclose the market.

In any case, in practical terms it may be that the scope for additional legal harmonisation is fairly narrow. For example, it is difficult to imagine fully harmonising the efficiency incentives fundamental to ex ante regulatory approaches at Community level, and it is not entirely clear what Treaty justification would be for the Commission to pursue this.

However, legal harmonisation is far from the only route forward and, perhaps, one way of making progress could be through a Commission Communication or working paper providing further regulatory guidelines. Greater harmonisation in good regulatory practice, for example, in terms of approaches to access pricing may also be better pursued through greater regulatory cooperation rather than by legal harmonisation.

However, whilst there may be many ways to cook this particular egg, the direction of Community regulation is clear- heading towards greater harmonisation and an (ever so) gradual movement towards a European regulation.

Europe Economics is an independent economics consultancy, specialising in economic regulation, competition policy and the application of economics to public policy and business issues.

For further information, please contact David Stubbs:  
david.stubbs@europe-economics.com

For general enquiries contact: Samantha McCarron at:  
Europe Economics, Chancery House, 53-64 Chancery Lane,  
London WC2A 1QU  
Tel: (+44) (0) 20 7831 4717 Fax: (+44) (0) 20 7831 4515  
e-mail: enquiries@europe-economics.com

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<sup>8</sup> Protocol on Subsidiarity'-EC Amsterdam Treaty.