

Chapter 1

Competition, Universal Service and the Graveyard Spiral*

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1. INTRODUCTION

This paper provides another examination of the issue of competition and universal service in the postal sector. While there has been much interest in the issue, most of the debate so far has had the effect of generating more heat than light. This paper, while having lofty objectives, is unlikely to prove an exception. There have been two main camps. The one camp argues that further competitive entry will have a deleterious effect on a PO's ability to remain financially viable. The other argues that competitive entry conveys so many benefits in terms of increased efficiency that the risks of undermining the financial viability of the POs are very small compared to these benefits and should be ignored. The two camps agree on one thing: that the universal service obligation (USO) should remain. There may be some willingness to allow the USO to be relaxed, but this has proved difficult for POs to achieve in practice, as public outcry is the usual response to proposals to shut down post offices or relax the USO in other ways. The protagonists of liberalization usually cite the successful experience of New Zealand and Sweden. The problem is that both sides make powerful

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opposing arguments and there seems little prospect of any meeting of minds. Moreover, neither side has yet been able to show convincingly the superiority of one policy over the other. This arises primarily because of the rather complex nature of the issues involved.

This paper aims to inform the debate by providing a model of entry and access that integrates earlier contributions and provides some perspectives on the factors underlying the financial viability of a PO with a USO and facing various forms of competitive entry. Section 2 will review the debate so far on entry and access with a USO. It will relate the situation in posts with that in other industries, for example, telecommunications where these types of issues are also currently being addressed. This section notes factors identified in earlier papers that have been argued to affect the viability of a PO under entry. Section 3 will provide the motivation, underlying assumptions and a discussion of the principal results of a simulation model developed to study the issues. The intended contribution of the model is to synthesize a number of approaches and attempt to throw additional light on the impact of entry on POs facing a USO. Section 4 will be by way of conclusions and implications for entry and access policy. The Appendix sets out the analytical model underlying the simulations of Section.

2. THE DEBATE ON ENTRY

The USO drives the debate on entry. It provides the basis of a credible case against unrestricted entry. The USO is the obligation to deliver letters and parcels ubiquitously and, in the case of letters, at a uniform price. In addition, there is an obligation to provide some uniformity in service quality. While outlying areas get lower quality service, the general consensus is that delivery standards should not be drastically different from those of accessible areas. To meet these obligations POs have typically been granted a reserved area, a weight or price limit, where they are the only legal providers. Absent the obligation of the uniform price and some service uniformity, the ubiquity requirement could be satisfied without a reserved area. The question is then if a USO is to continue whether a reserved area is required. Crew and Kleindorfer (2000, 2001) have argued that a meaningful USO is unlikely to be feasible absent a reserved area or some other method of funding. This argument is further elaborated in Crew and Kleindorfer (2004) to accommodate economies of scope between letters and parcels. However, even with revenues derived from significantly increased parcel volumes, it seems unlikely for most countries that the lettermail USO can be supported without a reserved area, unless service standards are relaxed. Entrants would price below the incumbent in the low cost markets. The