

Chapter 3

Liberalization and Regulation of the Swiss Letter Market

Helmut M. Dietl,¹ Urs Trinkner^{1,2} and Reto Bleisch^{1,2}
University of Zurich¹ and Swiss Post²

1. INTRODUCTION

The European Union is gradually opening up its domestic letter markets for competition. Complete liberalization is planned for 2009. In contrast to the European developments, the United States developed worksharing as a means to introduce competition in the postal sector. However, despite the examples of the EU and the U.S., in most countries letter services are still national monopolies.

In Switzerland, the universal service provider (USP) is Swiss Post, which currently enjoys a monopoly on addressed letters up to a weight of 1 kilogram. The Swiss government has the power to open up the letter market if the provision of the universal service obligation (USO) remains guaranteed. Hence, prior to any further market opening, it is crucial to know how competition affects the financial viability of Swiss Post with or without a licensing system. Such a licensing system has been introduced in the recently liberalized parcels market. The regulatory authority PostReg is entitled to collect licensing fees that amount up to 3% on an entrant's turnover to compensate Swiss Post for its universal service provision if needed.

* The views expressed in this paper are those of the authors and do not necessarily reflect the opinion of Swiss Post.

Our paper provides insights on the consequences of different kinds of liberalization or regulatory rules of the Swiss letter market. We examine welfare effects and financial consequences for both Swiss Post and potential market entrants. We start with an analysis of what would happen if the current regulation of the parcels market were applied to the letter market.

The paper proceeds as follows. In Section 2, we develop and tailor a game theoretic model to the Swiss postal system. In Section 3, we calibrate the model with Swiss data. Section 4 presents our results on end-to-end competition and compares them with an evaluation of the regulated monopoly of 2003. We show that end-to-end competition results in lower welfare and problems to finance the USO even if a licensing system is introduced. Building on these results, we expand the model in Section 5 and analyze alternative regulatory scenarios. We show that worksharing will increase economic welfare. The last section contains a discussion and our main conclusions.

2. BASIC MODEL AND FORMAL RESULTS

In order to analyze the effects of liberalization in the Swiss letter market, we use a standard game theoretic approach. On the supply side, we let Swiss Post as incumbent I compete with a representative entrant E . The demand side links the two operators. Customers value the available products with respect to quality and prices. Strategic interaction takes place, where one operator's behavior affects both operators' profits. For example, when the incumbent raises its prices, some consumers will switch to the entrant and boost the entrant's sales.

Technically speaking we use a Dixit-like approach to model price competition with product differentiation and assume that there are no information asymmetries.

2.1 Basic Model

On the *demand side*, we assume a representative sender with quasilinear preferences with respect to money.¹ The quasilinearity implies a cardinal utility measure that enables us to compute and compare overall welfare of

¹ Having in mind that most senders are businesses, quasilinearity is a reasonable assumption in the modeled riskless world. Businesses invest into mail as long as the NPV of an additional mailing is nonnegative, i.e. marginal utility of mail is greater than or equal to 1. Further, in an economy like Switzerland where postal consumption is small compared to total expenditure, postal consumption will be independent of the initial wealth endowment Y .