Chapter 6

Competition and the Coverage of Price Controls in the Postal Sector*

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1. INTRODUCTION

In general, the introduction of competition into a market is seen as a means to maximize economic efficiency and welfare. Competition and competition law act irrespective of whether a price control is in place and protect customers from, among other things, any behavior considered to be an abuse of a dominant position. The opening of a market to competition may provide an adequate level of pressure to incentivize the universal service providers (USPs) to become more efficient and may in itself be sufficient to protect the interests of the customer. Nevertheless, in most utility industries in the EU, regulators have been provided with powers to set price controls and further constrain prices, while competition is developing in the market.

In the postal sector, the EU Postal Directive[1] required Member States to partially open their postal markets in 2003. The Directive allows for the possibility of requiring full market opening in 2009. In such an environment, price controls have been applied to ensure the provision of statutory undertakings (e.g. universal service), encourage efficiency and

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* The analysis contained in this paper reflects the views of the authors. These views are not necessarily those of Oxera and the Royal Mail Group.

1 European Commission, European Directive 97/67/EC and amending Directive 2002/39/EC.

economy, protect customer groups, as well as encourage competition through providing sufficient headroom for market entry.

In other utility sectors,[2] with the prospect of developing a competitive market, price controls have been applied as temporary measures while competition develops. There are three significant and closely related effects to be considered when setting the control. First, the form of the price control may be designed to encourage competition into segments of the market. Second, the scope of the price control may be adjusted over time to match the pace of developing competition. Finally, the universal service obligation for the USPs may call into question the compatibility of such an obligation and fully competitive markets; therefore, regardless of whether there is a price control, there are issues over the financial viability of the USP in the presence of competition.

Price controls may not only provide additional protection to customers while competition develops, but may also alter the market to encourage competition into segments of the market. Price controls can hinder the USP's development of its service in order to meet customer needs by restricting its changes in non-price characteristics. The price-control arrangements may limit its flexibility in adjusting the output and quality of any given service. For example, if the services offered by the USP go beyond the mandated requirements of the universal service in terms of collection and delivery, the USP may wish to rationalize its services to meet the universal service requirements. Price controls can also limit the ability of the USP to amend prices and pricing structures in order to make them more cost-reflective.

Regarding the services included in price controls, there are essentially three ways in which the coverage of the price controls can evolve over time and ultimately be removed. The USP's services that become competitive can be removed from the coverage of the controls. Such an approach requires detailed analysis of the developing markets and the allocation of costs between the competitive and non-competitive market segments. Alternatively, the USP's services that could prospectively become competitive during the price-control period can be removed from the main control and either temporarily placed in a separate control (e.g. safety caps) or have no control applied to them. Finally, the USP's services that are competitive can be included in the same control as those services that are non-competitive until such time as all of those services are either competitive or prospectively competitive.

For example, Laffont and Tirole (1996) have stated that, in the presence of universal access to part of a USP's network that cannot be readily replicated by a competitor (and thereby forms a bottleneck), a global price

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[2] For example, telecommunications, and the electricity and gas retail business in the UK.