Chapter 7

Worksharing, Pricing and Competition in the Postal Sector*

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1. INTRODUCTION

In the postal sector, the practice of worksharing has been introducing a measure of competition even when the industry was otherwise monopolistic. When the customers have the possibility to "bypass" part of the postal network, there is effectively competition in the relevant segments between the operator's activities and those of the customers. From that perspective, one can think of the processing of workshared mail as a form of "downstream access" which is provided to the customers. The relevant question is then to know how the workshared product ought to be priced and more generally, how the possibility of worksharing ought to affect the operators pricing structure. This subject has been extensively studied in the literature (Billette de Villemeur et al. 2002, 2003,. Crew and Kleindorfer 1995, Mitchell (999, Sherman 2001 and Panzar 2002).[1]

When the market is liberalized and when entry occurs, a new kind of demand for workshared mail may emerge if the other operators do not have

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[1] See also Crew and Kleindorfer (1995), Mitchel (1999), Sherman (2001) and Panzar (2002).

their own delivery network, at least in some areas. The pricing of the services provided to competing operator raises the problem of "access pricing". The phenomenon of "downstream access" has been heavily debated in many network industries like telecommunication, electricity and gas, as part of the ongoing liberalization process; see for instance Laffont and Tirole (1996, 2000) and Armstrong (2002). A few recent papers have also looked at this problem for the postal sector, see Crew and Kleindorfer (2002) and Billette de Villemeur et al. (2003b, 2004). However, these contributions neglect the more traditional form of worksharing by customers. A fully fledged model of postal sector pricing would have to account for both the customers and the competitors demand for workshared mail. Panzar (2003) represents a first step in that direction. He uses the worksharing model of Billette de Villemeur et al. (2003a) in which he introduced upstream and downstream competition. However, he uses a rather specific setting and he does not characterize the optimal pricing structure. The current paper tries to bring together competitive access and monopoly worksharing models in a more systematic way.

Before proceeding it may be interesting to take a look at the fundamental issues underlying our problem. The regulatory design of postal prices including those for workshared mail is essentially a Ramsey-Boiteux pricing problem. The incumbent operator offers different products to different types of customers and we can think of workshared mail as one of these products. While some of these products are final goods, some like workshared mail may be intermediate goods which are used as inputs by other firms. The pricing of this intermediate good then indirectly determines the prices paid by the final consumers of these products. In a "perfect" (first-best) world the prices of all these products are equal to (long-run) marginal cost for all products. This provides consumers with the correct signals and ensures that the decentralized outcome is efficient.

In an industry like the postal sector, where technology involves "fixed" costs (like the cost of maintaining the delivery network) it is however, typically the case that marginal cost (even long-run marginal costs) are well below average costs.[2] Strict marginal cost pricing is then problematic because it implies that the operator cannot break even, which is usually considered as not acceptable for a number of reasons (including political economy considerations).[3] Consequently, one would have to impose positive markups on at least some products in order to meet the break-even constraint. The determination of these markups is precisely what the

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[2] Like most of the regulation literature we use the term fixed cost for the part of cost which is independent of output, *even in the long run.*

[3] In a first-best setting this problem can be overcome by a lump-sum transfer to the operator covering its fixed cost.