Current challenges of postal universal-service regulation in microeconomic pictures

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Introduction

– Postal regulation is about **markets**
– **Microeconomic pictures** are frequently used, but only for specific questions
– Idea: propose **one framework for a number of issues** in postal regulation as a common ground for discussions (textbook-style)
– Basic assumption: USOs have become a **binding constraint** for USPs (prices, scope/quality)
– Disclaimer: framework builds on many assumptions
Setup / benchmark

Baseline case: price-regulated USP

- See also Brennan and Crew (2016)
- USP just covers cost

The solvency problem created by volume decline

Assumptions: new technologies are marginal substitutes, operational costs are already optimized, no externailites (network effects), focus on mail market, ...
Responses: price policy and its limits

Continuing volume decline can render price policy impossible (Brennan and Crew, 2016)
Response: cost policy and its limits
(cost-policy = USO-scope reduction)

when demand does not react to USO-scope-reductions

→ when USO-scope reductions have little impact on demand, they are preferable to price policy

when demand does react to USO-scope-reductions

→ demand reaction may not be too strong
Combining cost- and price-policy

- cost policy can make price policy possible again

- only possible if demand reacts sufficiently little to cost cuts

- may be used when further cost cuts are hard to implement
Subsidies (compensations)
Alternative with bad dynamics

Subsidy per letter increases with volume decline
Total compensation may increase
With continuing volume decline, for more and more letters, subsidy becomes larger than its benefits

Subsidy = loss

basecase with solvency problem

subsidies with further volume decline

– Subsidy per letter increases with volume decline
– Total compensation may increase
– With continuing volume decline, for more and more letters, subsidy becomes larger than its benefits
Conclusions

− Regulating a growing market was easy, regulating a shrinking market is difficult

− Regulation needs to adapt constantly to continuing volume decline
  − raise prices, reduce USO-scope, increase subsidies (per letter)
  → “protracted winding-down process of postal regulation”; Hearn, 2018

− No sustainable solution ahead but abolishing the current concept of postal regulation altogether

− (Beware: Analysis rests on many assumptions)
Thank you.

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Background: What has changed demand?

**pre-internet age**

![Graph showing indifference-curves in the pre-internet age](image)

**internet age**

![Graph showing changes in indifference-curves due to technological advances](image)

Technological advances reduce the cost of using digital communication

→ intuition for assuming marginal substitutes (instead of cross-substitutes) (See Brennan and Crew, 2016)
Conclusion price policy vs. cost policy

– price policy is not possible when volume decline is severe
– the welfare effects of cost policy depend on how strongly demand reacts
– when USO-adjustments (cost reductions) have little impact on demand, they are preferable to price policy