

ADDITIONAL EU MAIL & PARCEL REGULATION: WHAT EVIDENCE TO LOOK FOR?

Revisiting old and new rationales and evidence for regulation

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- National regulators, including the US Postal Regulatory Commission.
- Many universal service postal operators in Europe.
- PostEurop industry association, providing evidence used to inform European policy conversations.
- Competitors in the mail and express industry, incl. the European Express Association.
- Online intermediaries, e.g. eBay, Facebook, Google, and industry associations CCIA and EDiMA.

In the context of the up-coming review of the Postal Services Directive, the ERGP¹ has called for a shift of regulatory focus from universal service provision to the promotion of competition by stating that:

“The changes in society as reflected in the postal market call for a reorientation from universal service provision to a proper functioning of the postal market and of competition as the main focus of a fit for purpose regulatory framework.”²

More specifically, in the ERGP’s view, *promoting competition in letter mail markets* remains a valid and important objective to pursue. Moreover, the *risks of future consolidation of market players and dominant operators leveraging their market power* from letter delivery markets onto parcel delivery call for *additional powers* for national regulators to intervene ex-ante in case of actual or potential competition problems.³

In this context, the ERGP suggests that national regulators should (i) have the competence to impose regulatory obligations such as access to the network and its components at cost-oriented prices, (ii) be able to impose a reference offer, and to (iii) conduct margin squeeze tests. Regulators should (iv) obtain powers to

¹ The European Regulators Group for Postal Services

² ERGP (2019), ERGP Opinion on the review of the regulatory framework for postal services (ERGP PL I (19) 12 Opinion on the review of the regulatory framework). p.7

³ Ibid. p.7-8

define, monitor and analyse markets (including adjacent markets like logistics and transport). Based on the market analysis and identification of one or more operators with Significant Market Power (SMP), national regulators should (v) have specific powers in determining how the access to the network should be provided (e.g. defining access prices, processes, interfaces, and formats).⁴

In this paper, we investigate whether the additional regulatory powers suggested by the ERGP are justified or not. We do this by first looking at the basic principles for when and why to introduce regulation. We thereafter take a specific look at the postal sector to assess whether the criteria for when to regulate are fulfilled there.

Our analysis indicates that there is no need to, and benefit from, extending the EU-wide postal regulation beyond what is already in place. The main reasons for this are that:

- Competition already works well in European e-commerce delivery markets;
- general competition law is an effective tool to prevent anti-competitive practices by dominant postal operators;
- existing sector regulation provides an additional layer of protection of competition and consumers; and
- subsidiarity ensures that national governments (if warranted by local conditions) can impose stricter regulation than the minimum level contained in the Postal Services Directive.

In order to reduce the risk of regulatory failure (particularly relevant to dynamic markets such as those for letter and parcel delivery), any regulatory intervention should be (i) based on a clear theory of harm and evidence of market failure, (ii) preceded by a strategic review of its long-term impact and (iii) subject to a judicial review process. Without these steps there is a high risk of regulatory failure where regulatory intervention harms market dynamics, brings USO sustainability at risk or cause other unfavourable outcomes.

Based on this review process, regulatory proposals that are appealing at the surface may become less attractive

when taking all the relevant factors into account. This requires an in-depth assessment of actual market conditions. For EU regulation, one would also have to consider the principles of subsidiarity.

CHAPTER 1. WHEN AND WHY REGULATE – BASIC PRINCIPLES

Policy makers have a varied set of tools to intervene in the functioning of different markets. What market elements should policy makers consider when assessing whether and, if so, with what specific tools to intervene?

Overview of regulatory tools to intervene in non-functioning markets

The concept of regulation refers to different tools that can be more or less intrusive. It can refer to laws that directly mandate business practices (e.g. installing filters on factory chimney stacks). It can also refer to legislators delegating rule-making and monitoring powers to specialised agencies. Regulation seeks specific policy outcomes on a specific market, e.g. ensuring security of energy supply, providing an essential but uneconomic service, or protecting vulnerable consumers.⁵

Regulatory intervention to ensure the specific policy outcomes is only warranted if there is a so-called *market failure*. Without specific market failures, competitive markets provide the efficient amount of goods and services, i.e. the amount which best meets consumers' needs and preferences, given scarce resources. Examples of market failures are market power, externalities, asymmetric information and public goods. In this paper, we focus on the market failure linked to market power. The reason for this is that the ERGP's suggestions regarding additional regulatory powers are clearly linked to competition concerns.

Market power occurs when a firm can profitably raise the prices of its goods above the competitive price level. The existence of market power implies that the firm may produce a lower quantity of the good than socially optimal and part of the consumers won't be able to purchase the good at the new price, leading to a deadweight loss for society. Market power also implies that a firm can behave independently of its competitors, thereby giving

⁴ Ibid. p.9

⁵ Commissioner Almunia (2010), 23 March 2010 speech, available at: http://europa.eu/rapid/press-release_SPEECH-10-121_en.pdf.

it the opportunity to exclude as-efficient competitors from the market.

Powers given to specialised agencies to overcome market failures can be different. Well-known examples are the enforcement of competition law across the entire economy or the application of sector-specific regulation.

Competition law is the primary tool to tackle competition-related problems

To tackle market failures related to market power, EU powers ensure deep harmonisation and delegated powers within the field of competition law. DG COMP and national competition agencies apply the TFEU competition articles and the competition rules apply to all sectors of the economy.

A key principle in competition law is that it sets boundaries for what a firm with a dominant market position can do. Therefore, a key question is whether a firm has a dominant market position or not. The answer to this question depends on the specific market conditions – which will change over time as technology and consumer preferences evolve. In this way the boundaries of competition law are dynamic and adapt to the market development. The competition agencies also have a track record of conducting empirical work, applying the competition economics toolbox, so to ensure that any future analyses reflect the evolution of business and market conditions. In contrast, a static approach where sectoral laws define the scope and subject of regulation (ex-ante regulation), would fail to hit a fast-moving target, if demand and technologies evolve.

Criteria to add sector-specific regulation on top of the existing competition law framework

In certain instances, ex-post competition law is considered too slow to tackle market failures relating to market power. This can be the case in markets with no effective competition and high barriers to entry, such as telecoms, where the Commission has identified several specific markets susceptible to *ex ante* regulation.

In these instances, however, one needs to demonstrate that there is a robust justification for introducing sector-specific regulation as an additional layer of protection on top of the existing competition law framework. The criteria that normally are applied as part of this exercise are the following:

- The presence of high and non-transitory barriers⁶ to entry;
- A market structure which does not tend towards effective competition within the relevant time horizon;
- The insufficiency of competition law alone to adequately address the market failure(s) concerned.

In order to introduce ex-ante regulation, the three criteria listed above must be cumulatively met.

In what circumstances is EU level regulation necessary?

When discussing the role of national vs. EU-level regulation, an important principle is *subsidiarity*. In the EU context, in areas not falling within the Union's exclusive competence, the principle of subsidiarity rules out EU intervention when an issue can be dealt with effectively by Member States at central, regional or local level. It also means that the EU can exercise its powers only when Member States are unable to achieve the objectives of a proposed action satisfactorily or added value can be provided if the action is carried out at EU level.⁷

CHAPTER 2. THE POSTAL SECTOR REGULATORY LANDSCAPE

The three versions of the Postal Services Directive have gradually liberalised the delivery of letters, historically taken care of by national monopolies. Since 2013, all letter markets in the EU are fully liberalised. The delivery of packets and parcels has always been open to competition. What has this development implied for the application of legal and regulatory frameworks in the postal sector?

⁶ These barriers can be either structural, legal, or regulatory.

⁷ Art. 5 (3) TEU, <http://www.europarl.europa.eu/factsheets/en/sheet/7/the-principle-of-subsidiarity>

EU competition law ensures that postal market competition can develop for the benefit of citizens and businesses

In newly liberalised markets, national postal operators naturally hold strong market positions with respect to the delivery of letters. Holding a dominant position is not anti-competitive *per se*. However, abusing a dominant position by trying to exploit consumers or exclude as-efficient competitors from the market is. Thus, when there is a dominant incumbent in the market, there is a higher risk that the incumbent will use its market power in an anti-competitive manner.⁸ General competition law addresses such abuses of a dominant position – in the postal sector just as in any other sector.

In fact, over the years, the postal sector has been subject to many competition enforcement cases at both EU and national level. Some of the cases from this industry have even helped progress the frontier of competition law and economics. Examples of this is provided by the Post Danmark I and II cases.

In Post Danmark I⁹, the European Court of Justice concluded that the fact that a dominant undertaking engages in a practise that may be called “price discrimination”¹⁰ cannot of itself suggest that there exists an exclusionary abuse under Art. 82 EC (now Art. 102 TFEU). In order to assess the existence of anti-competitive effects in these situations, it is necessary to consider whether the pricing policy in question, without objective justification, produces an actual or likely exclusionary effect to the detriment of competition.¹¹

In Post Danmark II¹², the European Court of Justice stated that charging prices below cost to customers is not a prerequisite of a finding that a retroactive rebate scheme operated by a dominant undertaking is abusive. That conclusion should, however, not exclude recourse to the “as-efficient-competitor” (AEC) test in relation to rebates and their compatibility with Art. 82 EC (now Art. 102 TFEU).¹³

These two competition law cases have reduced regulatory uncertainty with respect to pricing practices, not only in the postal sector, but also in other industries.

An overview of competition law cases in European postal markets during the 2013-17 period reveals that the competition law framework also today is actively enforced at both EU and national levels. Within this timeframe, almost 40 postal sector competition cases were opened, covering different products and services, see Table 1. Whereas 13 of these cases were handled by European legal institutions, more than 30 cases were investigated by national competition authorities.

Table 1 Competition cases in the European postal market, 2013-2017

| Topic | # Cases | Market segment |
|------------------------|---------------------|--|
| Merger | 9 EU | Letter post; Parcel & express; Postal services |
| Access | 4 national | Letter post; Parcel & express; Postal services |
| Cartel | 1 EU | Postal services |
| Abuse of dominance | 1 EU 2 national | Letter post; Parcel & express; Postal services |
| Discriminatory pricing | 1 national | Letter post |
| Excessive pricing | 1 national | Letter post |
| Predation | 6 national | Letter post |
| Rebates | 2 EU 11 national | Letter post; Parcel & express; Postal services |
| Zonal pricing | 1 national | Letter post |

Source: Copenhagen Economics (2018) *Main developments in the postal sector (2013-2016)*.

Out of the cases above, 9 dealt with mergers, covering both letter and parcel delivery. Any concerns about a potential consolidation of market players in the future (as highlighted by the ERGP in its opinion) could thus be expected to be handled by means of general competition

⁸ Copenhagen Economics (2012) Pricing behaviour of postal operators, p. 16.

⁹ Case C-209/10 – Post Danmark, Judgment of the Court (Grand Chamber), 27 March 2012, Nr.30

¹⁰ “Price discrimination” (sometimes referred to as “price differentiation”) means that a firm charges different prices to customers or

groups thereof for goods/services whose costs are equal or, conversely, charges a single price to customers for whom supply costs differ.

¹¹ Case C-209/10 – Post Danmark, Judgment of the Court (Grand Chamber), 27 March 2012, Nr.44

¹² Case C-23/14 – Post Danmark, Judgment of the Court (Second Chamber) of 6 October 2015, Nr.56

¹³ Ibid. Nr. 58

law. Two other areas of concern highlighted by the ERGP are access and the leverage of market power in terms of exclusionary or exploitative abuses. As visible from our overview, during 2013-17 there were 4 access cases and 25 cases dealing with abuse of dominance or more specific exclusionary/exploitative abuses.

The range of competition enforcement cases across postal markets indicates that all firms in the sector (large or small; established or new entrants, irrespective of market segment) can expect competition agencies to address any specific competition issues. This clarity is associated with a deterrent effect, since competition compliance is expected to be a priority across the sector.

Overall, there is thus no indication that competition policy is not an effective tool to deter and handle anti-competitive practices within the postal sector.

Sector specific regulation already provides an additional layer of protection

In the postal industry, the Postal Services Directive¹⁴ provides an extra layer of protection by:

- requesting Member States to ensure that *transparent, non-discriminatory access conditions* are available to elements of postal infrastructure or services provided within the scope of the universal service whenever necessary to promote user interests and/or to promote effective competition¹⁵,
- confirming Member States’ right to adopt measures to ensure *access to the postal network under transparent, proportional and non-discriminatory conditions*,
- obliging universal service providers to apply *transparent and non-discriminatory tariffs and associated conditions* when applying special tariffs,
- obliging universal service providers to apply *affordable and cost-oriented prices* to the services forming part of the universal service obligation.

Thus, the existing regulatory framework already allows/requests Member States to (where warranted) introduce obligations with respect to access to the postal delivery network. Several Member States are actively pursuing

this opportunity and could be expected to do so also in the future. The existing regulatory framework also seeks to ensure ex-ante that prices applied by universal service providers to its competitors and customers will not lead to exploitative or exclusionary abuses.

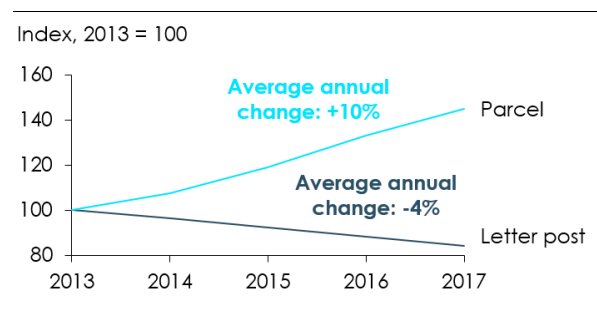
CHAPTER 3. IS THERE A NEED FOR ADDITIONAL EU POSTAL SECTOR REGULATION?

From the economic perspective, an efficient regulatory approach (i) is targeted at solving identified market failures and (ii) justifies the added burden to the regulated firm(s) and the implied uncertainty to players in the market. In this chapter, we appraise the case for additional EU postal sector regulation.

European postal markets – is additional regulation justified?

Technological development is transforming the postal sector on two fronts. On the one side, electronic communication is replacing paper-based communication (so-called “e-substitution”), decreasing the demand for delivery of letters. Between 2013 and 2017, letter post volumes decreased by an average 4% per year in the EU. On the other side, electronic commerce (“e-commerce”) is increasing the demand for delivery of parcels and packets with parcel & express volumes increasing by an average 10% per year between 2013-2017, see Figure 1.

Figure 1 Development of letter post and parcel & express volumes in the EU, 2013-2017



Source: European Commission; Copenhagen Economics (2018), *Main Developments in the Postal Sector 2013-2016*

¹⁴ See Articles 11a and 12 of Directive 2008/6/EC

¹⁵ This includes postcode systems, address databases, post office boxes, delivery boxes, information on change of address, re-direction services and return to sender services.

What does this development mean for the emergence of market failures linked to market power?

Based on our initial review, we cannot find evidence of any market failures in the EU postal market that would warrant additional regulatory intervention on top of the existing regulatory framework. The reason for this is threefold.

First, entry barriers in EU postal markets are low. *Second*, the competitive pressure in EU postal markets is strong and growing. *Third*, there is no evidence of general competition law being insufficient to adequately address any potential market failures.

Barriers to entry are low. Actual market developments have demonstrated that new business models unlock commercial opportunities for new market entries in the postal sector. New market entrants have developed their own networks and compete for both parcel and letter delivery customers. For instance, we have seen private companies deploying automated parcel delivery machines (where “traditional” parcel delivery does not work as consumers expect it to) or offering low cost mail services where business mailers have high price elasticities. Thus, new business models can be an important driver for new market entries.¹⁶

Naturally, the attractiveness of market entry is higher in the growing parcel delivery segment than in the declining letter delivery segment. Nevertheless, we observe competition taking place also for letter delivery, often based on business models different from those of the universal service providers. This includes business models built around delivery fewer days per week, delivery in selected geographical areas, and delivery by means of lower cost labor models.¹⁷ In the parcel delivery segment, there is a variety of players active in B2C delivery of products bought online. Already in 2012, there was only one Member State with only one alternative to the national postal operator available for the delivery of domestic B2C parcels (not taking into account the presence of multinational operators, such as DPD or DHL). In all other Member States, there were at least

two domestic alternatives to the national postal operator available and in nine Member States the number of domestic alternatives were at least five.¹⁸ Due to the growth of e-commerce, we expect this number to have grown since 2012. An overview of main providers of domestic and cross-border B2C parcel delivery services from 2018 shows that this indeed has been the case. According to this overview, there were on average nine different carriers active in domestic B2C parcel delivery and more than eight different carriers active in cross-border B2C parcel delivery across the EU Member States.¹⁹

Competition is strong and growing. The extent and intensity of competition in a market depends fundamentally on the demand side. Whereas demand for traditional letter delivery is shrinking, this market segment is facing increasing competition from digital alternatives. Thus, competition in terms of alternative postal delivery networks is weak in many markets and providers of universal postal services are struggling to maintain a financially sustainable letter business.

In the postal industry, characterized by economies of scale, there can be a trade-off between the policy goal of increasing the number of operators to enhance competition and securing a financially sustainable provision of universal postal services. New market entrants can compete fiercely for volumes in areas that are profitable to serve, making it harder – and eventually even impossible – for the universal service provider to sustain a profitable USO. Since volumes and market conditions vary significantly over time and across countries, so will this trade-off. The current Postal Services Directive acknowledges variations in market conditions and allows Member States flexibility with respect to the application of regulatory tools. As a result, some Member States do for example enforce downstream access whereas others do not.

The delivery of parcels never has been subject to legal monopoly and parcel markets across Europe are known to be highly competitive. Moreover, the steady increase in e-commerce has created (and continues to do so) an

¹⁶ See Copenhagen Economics (2018), Main Developments in the Postal Sector (2013-2016), p.87

¹⁷ See for example Copenhagen Economics (2010), Main Developments in the Postal Sector (2008-2010), p.151

¹⁸ Copenhagen Economics (2013), E-commerce and Delivery, p.118.

¹⁹ PostEurop (2018), Deliver4Europe Facts & Figures, <https://deliver4europe.eu/facts-figures/>

increasing demand for parcel delivery services. This situation is attracting new players, often using innovative business models and delivering high competition at the local, national and international level.

A recent study about the development of cross-border e-commerce through parcel delivery carried out on behalf of the European Commission supports this conclusion. According to this study, the diversity of carriers in European postal markets is increasing and competition is becoming even more intense in B2C delivery markets – both concerning domestic and cross-border deliveries.²⁰

No evidence of general competition law being insufficient. As demonstrated in chapter 2 of this paper, the application of general competition law in the postal sector and the number of cases pursued at national as well as on EU level indicates that the general competition law framework is actively exercised. Based on our review, we can therefore not find any evidence of general competition law being insufficient to address adequately any potential market failures linked to market power in the postal sector.

Conclusions and outlook

In its opinion on the review of the regulatory framework, the ERGP calls for additional powers for regulators to be able to intervene ex-ante in European postal markets. The proposed powers include a mandate to define, monitor and analyse markets, the competence to impose ex-ante regulatory obligations, and specific powers in determining how access to the postal network has to be provided.

Our analysis provides no evidence in support of additional regulatory powers. We also cannot find any evidence of a structural problem that would warrant additional regulation at EU level. The main reasons for this are that:

- Competition already works well in European e-commerce delivery markets;
- general competition law is an effective tool to prevent anti-competitive practices by dominant postal operators;
- existing sector regulation provides an additional layer of protection of competition and consumers; and
- subsidiarity ensures that national governments (if warranted by local conditions) can impose stricter regulation than the minimum level contained in the Postal Services Directive.

Moreover, dynamic market place realities such as structural developments, innovations, technical progress, development of substitute services, and changes in consumers' needs and preferences for delivery services imply a significant risk of any new regulation leading to regulatory failure.

In order to reduce the risk of regulatory failure, regulatory intervention should be (i) based on a clear theory of harm and evidence of market failure, (ii) preceded by a strategic review²¹ of its long-term impact and (iii) subject to a judicial review process.²² For EU regulation, one would also have to consider the principles of subsidiarity. Based on this, regulatory proposals that are appealing at the surface may become less attractive when taking all the relevant factors into account. This requires an in-depth assessment of actual market conditions.

²⁰ WIK Consult (2019), Development of Cross-border E-commerce through Parcel Delivery, Delivering for the Future III: Workshop on Developments in the Postal Sector, Brussels 29 January 2019, p.16

²¹ The aim of the strategic review is to provide a cost-benefit assessment of the impact of intervention. Moreover, it should take market dynamics into account and consider whether any of the regulatory remedies is in practice hard to reverse – as this can bring extra costs

over time. Last, but not least, it should address long-term issues, which span beyond the horizon of a standard market review.

²² A judicial review is the process of challenging the lawfulness of decisions of public authorities, usually local or central government. Without this process, there is a higher risk of the new regulation prohibiting behavior that is actually beneficial for competition.

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