



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 18.10.2006
COM(2006) 596 final

**REPORT FROM THE COMMISSION
TO THE COUNCIL AND THE EUROPEAN PARLIAMENT**

**Prospective study on the impact on universal service of the full accomplishment of the
postal internal market in 2009**

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(Text with EEA relevance)

1. BACKGROUND AND PURPOSE OF THIS REPORT

Ever since its launch more than 15 years ago, the main objective of EU postal policy has been to secure a sustainable high quality universal service for all customers and EU citizens throughout the Community. The EU postal reform agenda decided by the EU legislator has consisted of a prudent step-by-step phasing in of competition into postal markets so as to improve on the efficiency, quality and choice of postal services – with the eventual target of full market opening. Over the last 15 years, the remaining monopolies have been gradually reduced, and postal actors have been given time to adapt their organisations to the new situation. The Postal Directive notes 2006 as the year for the Commission to confirm, if the postal reform agenda can be pursued and the last step for full market opening in 2009, as envisaged by the Directive, be taken. At this critical point, the Directive explicitly requires¹ the Commission to present a “prospective study” to assess whether this could be done while maintaining the universal service.

The analysis presented in this Study focuses on a prospective outlook and assesses what would happen to universal service in a scenario of full market opening in 2009. This question cannot be answered without addressing the closely related issue of how universal service is to be financed in the absence of any monopoly (or "reserved area"). In this Study, the Commission has deliberately chosen a very cautious approach, focusing on the long-term sustainability of universal service provision for the benefits of EU citizens and businesses.

This Report, the Commission’s Prospective Study, builds upon the findings of PriceWaterhouseCoopers’ (PWC) sector study on the impact of full market opening on universal service². In addition, it is based on a number of other elements, in particular the findings from previous sector studies³, experts’ reports, extensive consultations with stakeholders, research, as well as experience with competition in postal markets and other sectors.

This Report reiterates the objectives of EU postal reform and presents the state of play of postal universal service in the EU including future market trends. It assesses the potential impacts and opportunities that a postal internal market open to competition will have on universal service and related Community objectives in this area (employment and social

¹ Article 7(3) of Directive 97/67/EC as amended by Directive 2002/39/EC.

² "The impact on universal service of the full market accomplishment of the postal internal market in 2009", PriceWaterhouseCoopers, 2006 (hereafter PwC 2006).

³ 20 studies have been commissioned by the Commission since the start of EU postal reform, see: http://ec.europa.eu/internal_market/post/studies_en.htm

aspects). Finally, the Report addresses possible accompanying measures to mitigate any possible risks, including alternative funding mechanisms for universal service.

2. THE OBJECTIVES OF EU POSTAL REFORM

EU postal reform has been designed to improve on the static situation of varying quality and limited choice in postal services provided by incumbent operators holding postal monopolies in each Member State.

Acting in response to the imminent changes in the traditional postal market and the need to develop the European internal postal market, the EU legislator chose to introduce more competition in the market to give the necessary incentives to address the need for efficiency and better quality⁴. A regulatory framework was put in place to monitor market developments and control the provision of universal service.

The EU definition of universal postal service is based on two main elements: a range of services, and the conditions attached to their delivery. Universal service is defined in Article 3 of the Postal Directive⁵. It can be summarized as access to a range of services (letters, packages, insured and registered items, other postal items) under conditions of affordability (prices), accessibility and quality requirements (collection and delivery 5 days a week, limited transit time) and compliance with "essential requirements" (e.g. privacy of correspondence).

In line with the principle of subsidiarity, the broad definition of universal service in the Postal Directive is applied in different ways across the EU, thus reflecting national and societal needs. Derogations are permitted under exceptional circumstances (e.g., reducing delivery frequency to very remote areas).

The funding of universal service still mainly relies today in a majority of Member States on a reserved area or remaining monopoly (complemented by economies of scale and scope), enjoyed by incumbent public operators. If the reserved area provides a comfortable mechanism to fund the provision of universal service, it remains the most important barrier to achieving the internal postal market. As indicated by the 1992 Green Paper on the development of the single market for postal services, proper incentives are needed for operators to adapt services, to innovate, and to provide an efficient universal service to all EU citizens. The logic of controlled market opening was therefore confirmed by the Commission in 1992, the Council in 1994, the European Parliament and Council in 1997 and 2002, and by successive Commission Reports on the application of the Postal Directive, on condition that universal service can be safeguarded⁶.

3. UNIVERSAL POSTAL SERVICE PROVISION: THE STATE OF PLAY

Recent analysis indicates that there has been a satisfactory level of development of universal postal services in Europe: universal service is of high quality, prices are affordable, access to

⁴ Green Paper on the development of the single market for postal services - COM(91) 476.

⁵ Directive 97/67/EC of the European Parliament and of the Council on common rules for the development of the internal market of Community postal services and the improvement of quality of service, as amended by Directive 2002/39/EC

⁶ COM(91) 476; OJ C 48, 16.2.1994; Directive 97/67/EC and Directive 2002/39/EC; COM(2002) 632; COM(2005) 102; COM(2006) 595.

services is easy, and many operators make substantial profits⁷. The positive impact of postal reform so far was also noted in the Commission Reports on the application of the Postal Directive⁸ as well as in the recent Resolution of the European Parliament⁹.

The current picture also shows a radically different postal service as compared with the traditional one: postal operators are now complex modern industry operators competing with other communication media in a dynamic environment. More than 87.5% of the mail is originating from business. In addition, recent technological developments are impacting the way postal service is provided and are also challenging its core activity. In this context economic actors, notably small and medium size enterprises, playing an active role in different stages of the postal value chain represent an important source of opportunities for the future growth of the postal sector¹⁰.

Some Member States have already introduced full or significant postal competition in advance of the EU agenda, or have firm plans to do so, to the extent that around 60% of EU letter post volumes are expected to be completely open to competition by 2008. In these countries, despite the absence of a reserved area, universal service requirements have been retained and met. Examples in Sweden, Finland, and the United Kingdom show that the efficiency and reliability of postal services have been improved and meet the needs of citizens and businesses¹¹. Perception from consumers of access to postal services is very different per national market¹².

The analysis of the detailed provision of universal service requirements (affordable prices, specified quality, ubiquity of network of post office) as well as changes in the working environment changes demonstrates that operators and customers are feeling the impact of changes in the sector, irrespective of market opening. Key drivers such as demand, technological developments, organisational changes and regulatory regimes are impacting the way universal service is provided¹³. A new dynamic has evolved, with increasing professionalisation in the provision of universal service, improved services and more value delivered to customers.

⁷ "Main developments in the postal sector (2004-2006)", Wik -Consult 2006 (hereafter Wik 2006).

⁸ COM(2002) 632, COM(2005) 102, COM(2006) 595.

⁹ European Parliament resolution on the application of the Postal Directive (Directive 97/67/EC, as amended by Directive 2002/39/EC) (2005/2086(INI)), February 2006.

¹⁰ "The European Mail Manifesto: Growth, Partnership and Innovation in a changing industry" Postal Users' Group, 2006.

¹¹ "A broad economic analysis of the effects of liberalising the postal market", Swedish Institute for growth policy studies 2005.

¹² *Source*: Eurobarometer survey 2002 (only EU-15), 2003 (only NMS), 2004, 2006 and Focus Groups 2006.

¹³ "Technology and innovation in the postal sector", A D Little 2004; "European landscape in 2015", Boston Consulting Group, 2006 (hereafter BCG 2006).

4. POTENTIAL IMPACTS ON UNIVERSAL SERVICE IN A FULLY OPEN MARKET SCENARIO

4.1. Impact on the provision of universal service

Access to postal services

The change in the traditional way of accessing postal universal services is already apparent, reflecting notably how consumers now access postal services, and no further significant change is expected following full market opening. On the positive side, better aligned and higher quality services are expected; on the negative side, access in remote areas may be affected, which may imply the need for assisting measures if insufficient alternatives are offered by universal service providers and other market actors. In a multiple operators environment, in particular during the transition period, regulatory supervision will be necessary to guarantee the access to services for consumers and small and medium size enterprises.

Quality of service

Ubiquity of delivery and high quality of services are the most important marketing advantages of incumbent universal service providers. It would be not logical for them, under full competition, to reduce their standards. For less attractive market segments, in the absence of competitive pressure, continued regulatory control and monitoring may be needed to ensure quality¹⁴.

Price and affordability

In general, the expected impact of full market opening on universal service is a better alignment of services with actual needs and the willingness of consumers and small companies to pay for these services. For smaller customers and, even more so, those consumers who only devote a very small part of their overall budget to postal services, pricing stability remains important and regulatory safeguards in the form of price cap mechanisms can be introduced to control developments.

4.2. Impact on the financing of universal service

Market forces will increasingly contribute to a more efficient universal service provision and limit the cost of the residual part which would be of no direct economic interest. However, the future of universal service cannot be put solely in the hands of market forces. A certain degree of commercial freedom will have to be granted to universal service providers (notably releasing the price uniformity constraint for bulk mail), and, if justified and proportionate, ad-hoc funding may be necessary. In addition and notably in markets with low volumes per capita, regulatory measures can also be implemented.

4.3. Impact on employment aspects

Restructuring of incumbent operators is an on going trend, and market opening is only one of its drivers. Overall, there is more potential to be gained in supporting a more dynamic open

¹⁴ "The evolution of the regulatory model for European postal services", Wik-Consult 2005 (hereafter Wik 2005).

market, which will benefit the wider industry, than in maintaining the current status quo¹⁵. It is expected that the effects induced by complete market-opening in expanding the overall size of the postal markets and in facilitating integration and competitiveness with alternative methods of communication and transport will further contribute to maintain sustainable employment within universal service providers as well as facilitating the creation of new jobs in other operators and new entrants.

4.4. Impact on territorial and social cohesion

To the extent that universal service providers fulfil a social role, they may have to request adequate financial compensation. Appropriate answers should and can be found at national level, where such claims can best be assessed and the appropriate answer in terms of financing can be given (see examples in France and Norway)¹⁶.

4.5. The relevance of differences in Member States

An important point to consider in this assessment is the different impact on market opening in each Member State, taking into account the situation of its national postal market and the different stages of preparedness of incumbent universal service providers. It is claimed that, depending on these differences, market opening may in certain Member States be detrimental to the provision of universal service. The study undertaken by PwC has reviewed all differences across the EU in the event of a fully open market scenario and has concluded that in no Member State would market opening in 2009 jeopardize universal service, nor should it, as a consequence, be postponed. This confirms the Commission's own assessment and other evaluations, notably the Ecorys study which gives additional details on the perspectives of the development of competition for each market; two successive studies on the development of the European postal market by Wik-Consult; and the study on postal economics by Nera (although not reporting formally on a country format, these three studies converge in the same direction)¹⁷.

On a case by case basis, certain measures may be needed at Member State level to address any insufficient degree of preparedness of the incumbent operator. This should enable the incumbent to restructure without downgrading universal service. Confirming the final date for full market opening will bring the incentives to finalise preparation in time. Any specific problems that some universal service providers might face may be mitigated by additional safeguards - without the necessity to postpone full market opening beyond 2009.

4.6. Risks in delaying reform

Without the prospects of actual market opening, long term provision of universal service may be threatened¹⁸. Further investment is needed to meet new market challenges and to continue providing universal service as national governments confronted with budgetary restrictions are becoming less ready to invest in the postal infrastructure¹⁹. In assessing the opportunity to

¹⁵ BCG 2006 p. 19.

¹⁶ PwC 2006 p. 169.

¹⁷ "Economics of postal services", Nera 2004; "Development of competition in the postal sector" Ecorys 2005 (hereafter Ecorys 2005); "Main developments in the European postal sector", Wik-Consult 2004 (hereafter Wik 2004); Wik 2006, PwC 2006.

¹⁸ "Giving customers choice: a fully open postal services market", Postcomm 2005.

¹⁹ Wik 2006 p. 159.

invest in the sector, actors will need regulatory certainty and confirmation of market opening for unlocking the potential of the postal market.

In addition, continued monopoly protection would not give the necessary incentives to incumbents to deliver quality and efficiency to the benefits of all users. Prospects of (endless) price increase will prompt users to switch to alternative communication media. This would also deter current investments plans, would limit the search for innovation and value added services. Moreover, jobs in the postal sector would be at risk in the long term, as would those in adjacent sectors which depend on a dynamic postal market. In short, delaying the process would give the wrong signal to the market.

In the absence of further market opening, additional regulatory intervention would be required to stimulate and guide competition without necessarily ensuring greater efficiency and customer focus. This would run counter to the idea of better and more focused regulation which is the approach increasingly adopted across the EU²⁰.

5. COMPLEMENTARY AND ACCOMPANYING MEASURES TO SAFEGUARD UNIVERSAL SERVICE UNDER FULL MARKET OPENING

5.1. Different layers of measures: market forces, EU/ Member States regulation

There is a set of possibilities which will result from market forces and EU or national regulation, which will assist market opening while safeguarding universal service. The initial step is the commitment of universal service providers to adapt to the new situation and allow universal service to benefit from dynamic efficiencies (through reorganisation, more customer orientation, or adaptation of the workforce). The second step is to provide postal customers with additional safeguards for universal service through the regulatory framework at EU and/or Member State level. Finally, if needed and justified, the possibility to request funding for the universal service should be available.

In that order, these different measures offer a wide range of options for decision makers to choose from so as to meet best their national specificities. Numerous research and case studies confirm that these measures can be implemented with the appropriate commitment of stakeholders²¹.

5.2. Market answers: dynamic efficiencies

Developing volumes

In view of the importance of economies of scale for the universal service provision, mail volumes are a key contributor to smoothen the potential impact of market opening. There are significant growth expectations for markets with low volumes per capita²², notably those that are likely to be the most affected by market opening²³. Finally, extended partnership with the mailing industry can significantly improve conditions to further develop volumes. By

²⁰ "Better Regulation for Growth and Jobs in the European Union" - SEC(2005) 175.

²¹ Wik 2004; Ecorys 2005; WIK 2006; BCG 2006; PwC 2006.

²² Wik 2006 p. 202.

²³ PwC 2006 p. 119.

stimulating the use of mail as a media – including direct mail as a main contributor - , these factors will contribute directly and indirectly to the provision of universal service.

Diversifying revenues

There are market opportunities for postal operators, given some commercial freedom, to diversify their revenues and take benefit of economies of scope. On the basis of internal cross subsidies, universal service providers may indirectly secure their ability to provide universal postal service if necessary. There is ample room for postal operators to further engage successfully in adding activities to the value chain and building a wider portfolio of services. Many operators of different size and scale of ambition have already engaged successfully in post bank activities, the development of retail activities, logistics and express, regional or international developments, or increased partnerships with the logistics industry²⁴.

Restructuring of the universal service providers

Reorganisation of incumbents' operations is a key element in the adaptation to full market opening, which should enable them to face competition while maintaining the level of universal service, and in fact to provide all users with more efficient services. A number of benchmarks indicate that there is ample room for cost reduction and highlight possibilities to restructure within different timeframes and modalities²⁵.

Finally, since a large percentage of the labour force is approaching retirement age, it should be possible to gradually adapt the employment level, if this becomes necessary to adapt to the new market situation.

5.3. Regulatory safeguards

There is no one single solution to prepare for market opening. A combination of different proactive measures at market level and the firm commitment to reform will allow universal service providers to face, and to benefit from, market opening. In addition, certain regulatory measures may be appropriate as complementary safeguards for universal service.

Measures to ensure the universal service

The Postal Directive (e.g., Articles 4 and 22) explicitly provides Member States with the framework for securing universal service provision, including explicit requirements on customer protection. National Regulatory Authorities established through the Postal Directive are best suited to monitor the provision of universal service and to take appropriate measures, should it be at risk. They have the possibility to determine the most efficient and appropriate mechanism to guarantee the availability of the universal service, while respecting the principles of objectivity, transparency, non discrimination, proportionality and least market distortion.

Access to the universal service provider's infrastructure

While access to the universal service provider's infrastructure in a multi-operator environment may well be safeguarded by agreements amongst the operators, as the Swedish example

²⁴ Wik 2004; BCG 2006; PwC 2006.

²⁵ PwC 2006 p. 177; BCG 2006 p. 52.

demonstrates, National Regulatory Authorities may also assume a monitoring function in this regard.

Appropriate downstream access regimes (granting competitors access to the delivery network of the incumbent) can contribute to funding of rural routes or high cost areas²⁶. This issue can best be dealt with at national level to allow for flexibility and take account of national circumstances.

Commercial flexibility for business mail

Removing price uniformity constraints for business mail and giving some appropriate pricing flexibility to universal service providers will assist them significantly in adapting to market opening²⁷.

Joint role of regulatory and competition authorities

There is a risk that competition will not develop as anticipated and that the benefits of competition highlighted in the previous sections are not met. Competition is fragile in the initial phase, and there will be a need for adequate monitoring by regulatory and competition authorities²⁸.

Use of license regimes in exceptional circumstances

If appropriate and proportionate, licence regimes may continue allowing the introduction of specific requirements to new postal operators concerning quality, availability and performance of the relevant service so as to safeguard universal service.

Price cap mechanisms

The national regulator has the capacity (on the basis of adequate price cap mechanisms) to control the extent and pace of any eventual price increase and to maintain prices at a reasonable and justified level.

5.4. Safeguards relating to financing of the universal service

Even after Member States have introduced the necessary measures to facilitate the adaptation of the regulatory and market environment to conditions of greater competition²⁹, it cannot be excluded that in some Member States the financing of any residual justified net costs of provision of the universal service may still be required. A set of alternative options to the reserved area is available to provide for compensation (state aid, sector fees or compensation fund) or to find alternative ways to provide the service (public tendering, imposing universal service obligations on other operators). These mechanisms, possibly complementary, can be implemented at national level to the extent that they are needed and adequately justified. The implied proportionality test would induce more discipline than the reserved area.

²⁶ PwC 2006 p. 129; Wik 2005 p. 94.

²⁷ Wik 2005 p. 138; PwC 2006 p. 115.

²⁸ "The impact of competitive entry into the Swedish postal market", Cohen R et al 2006; Wik 2005; Ecorys 2005; Wik 2006 Annex A2.

²⁹ See the Commission proposal on postal VAT - COM(2003) 234 as amended by COM(2004) 468 - which is still under consideration in the Council.

6. CONCLUSION

Universal service can be safeguarded with full market opening in 2009

On balance, the approach chosen by EU legislators 15 years ago, namely the full accomplishment of the postal internal market together with a high quality of postal universal service appears to be sustainable and can be achieved by 2009 in all Member States. On the contrary, there are serious risks in delaying the process as the market is evolving quickly and needs further reform. The postal universal service, customers including consumers, and employment levels, would be best served if this evolution was accompanied by adequate regulatory monitoring, enabling actors to better interact in a competitive market.

For the European postal regulatory framework, the failure to acknowledge the evolving market developments may put pressure on the long-term sustainability of the universal service by not giving the right incentives to market forces.

Safeguard measures and alternative funding mechanisms are in place

Where necessary, a set of assisting measures are already in place, or could be made available, that provide universal service with the adequate support alongside the market evolution and thus ensure that EU citizens' needs are met by an efficient and reliable postal service. Such measures can also assist specific markets where the level of preparedness of the universal service provider would still be insufficient.

Alternative financing mechanisms have been identified to compensate, if necessary and proportionate, for the provision of universal service. Within the EU postal framework, subsidiarity will enable that the best-adapted combination of the different measures can be implemented to safeguard universal service.

Next steps

Full market opening is only a start towards the goal of having an effective competitive market, which will secure the long-term sustainability of universal postal service. A market transition period is foreseen where market forces will adapt to the new situation. Once the postal market has stabilized, assisting regulatory measures may cease to be needed and/or new ones may prove necessary. During this transition, market operators will have to adapt and regulators will need to monitor carefully developments to make sure that EU citizens and businesses can benefit fully from a high level universal service and the increased customer focus of all postal actors.