Foreword: Enduring questions and some lessons from practice

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My first CRR (Centre for Research in Regulated Industries) conference was the one held in Stockholm in 1994. Much has changed since then, but there are also a few constants. This conference certainly underlines both the changes we have seen as well as some persistent themes. In my remarks, I would like to touch on both. After a few words about the French regulator ARCEP and its main postal tasks, I would like to share with you two issues.

The first one is a practitioner's issue: what are the consequences of information asymmetry on the behavior of operators and regulators and their strategies?

As it compares the present to the past, the second issue is not especially one that a woman usually likes to address . . . but I shall endeavor to do so; for the past 15 years – and I hate to confess I have been there since those early times – why have so many questions remained the same? Why do so many topics still seem to be unsolved?

Let us start with the French Telecommunications and Posts Regulatory Authority, ARCEP (Autorité de Régulation des Communications Électroniques et des Postes). In 2005, the law gave the former Telecommunications Regulatory Authority (ART) the additional responsibility of the postal sector. Seven commissioners – I am one of them – are appointed for six years and their terms are not renewable. The President of the Republic appoints three of them, including the chairman. The President of the National Assembly appoints two other members as also does the President of the Senate. The seven commissioners together are in charge of Telecommunications and Posts. There is no specialization. A total of 160 people work in ARCEP, 11 on postal issues and 80 on telecommunications issues, with the rest of the staff supporting the Economic, Legal, International, Communication and General Administration Departments and working for both sectors.

Like other postal regulatory authorities and like almost all of us at this conference, ARCEP is mainly focused on its Universal Service Obligation (USO) and market organization. We monitor the USO, ensuring its funding while protecting consumers. This implies studying prices and setting price caps, cost accounting, monitoring quality of service, and assessing the cost of the USO. The role of ARCEP is to check that La Poste carries out its universal service missions properly, especially in terms of quality of service, and to supervise the funding of these missions. In this capacity, we regulate La Poste's universal service tariffs, especially through designing the incumbent operator's price cap.¹ In addition, ARCEP sets the accounting rules and establishes accounting system specifications, that is, the reporting format for regulated accounts. Last but not least, we are in charge of monitoring the conditions under which universal service is financed. In

particular, the Postal Law charges ARCEP with recommending to the government all measures necessary for guaranteeing the provision of universal service. The possibility of a compensation fund is also foreseen in the Law.

The second main scope of ARCEP's postal regulation, besides the USO, is postal market organization and the introduction of competition. This implies delivery of market authorizations, upstream regulation and statistical information. However, the day-to-day regulatory activity may also include very technical matters, such as access to mailboxes in apartment buildings or rulings on multiple postmarks on mail items. Opening up the postal market reveals unanticipated switching costs that are not always easy to reduce.

During the last CRRF Conference, in Albufeira, ARCEP presented the market situation in France.² Broadly, with regard to letter mail, only some 10 local operators are registered for domestic delivery. End-to-end competition is not significant at a macro level, but the upstream market is developed and it is quite open. Some 200 enterprises are active in the upstream market. It is estimated that mailing houses process 85 percent of advertising items. As for international mail, almost all incumbents of neighboring countries are present in the French market.

With regard to informational problems, it is well known that information is critical for regulation and information asymmetry can be a strategic issue. However, in my view, we should be more careful about it than we have been so far, and in a more practical way. It is a common element of theoretical models of economic regulation that the incumbent tends to keep secret as much information as possible in order to preserve its information rents. However, as a practitioner (on both sides) of the asymmetry dilemma, I have progressively acquired the strong intuition that cooperation with the regulator may also be a good strategic choice for an incumbent. I shall try here to reconcile these two opposing statements.

Let me begin by noting the robust theoretical finding from game theory that repeated games tend to promote cooperation and efficiency. The same is true in regulation. For example, theoretical contributions have shown how repetition tends to reduce the incentives incorporated in a price-cap mechanism. Indeed, if the financial results at the end of the first period show undue rents, the regulator will modify the price cap for the second period, making it difficult to preserve rents. Price caps are, of course, not the only 'repeated game'.

Indeed, the relationship between an incumbent and a regulator is a durable one. Since, not all topics are examined all the time, and some are subject to regulatory scrutiny only under exceptional conditions, it could be a winning strategy not to disclose some data. But many issues are examined on a continuing basis, such as accounting, quality of service, rates, and so on. In this process, no regulator likes discovering that requested information was hidden or distorted. According to my own experience, it is one of the more sensitive subjects: information is the regulator's raw material, as fuel is for an engine.

Fearing detection, an operator involved in a regulatory relationship may come to understand that 'reasonable' cooperation may also be a long-term profitable good practice – even if a part of its information rent seems to be more specifically at risk in the short run. However, the question remains: how can the regulator discover that information is false or hidden? We have learned from the economic history of monopoly regulation how difficult this is.

The quality of information available to the regulator should depend not only on

the incumbent's good will and good faith. The incentives for cooperative practice are greater when the regulator can rely on alternative sources, with the evident risk for a non-cooperating company of ultimate discovery of distorted information. There are at least four alternative sources.

The first source is trivial: *competition*, which enhances the quality of information except in the case of collusion. Indeed, markets yield information on prices and costs. This is duly observed in the case of the telecommunications sector, where competitors are also very helpful to the regulator as they provide valuable contributions in the process of public consultations. But, in the postal sector, competition is somewhat low. Moreover, the main competitors are incumbents in foreign countries. Although they are able to take part in the regulatory process and contribute to public consultation, they are reluctant to disclose information that could harm their interests in their own country. As for smaller competitors, it would cost them too much to participate efficiently as they lack the skills and the resources.

The second external source of information is *benchmarking*. Comparing European operators provides a remedy to deal with information asymmetry. Benchmarking functions like yardstick competition, highlighting the worst performers in a sample group and requiring them, implicitly or explicitly, to move closer to the best-practice frontier. In the telecommunications case, rules and procedures of the European regulatory framework are highly harmonized. Since regulators' tools and practices are very similar, benchmarks are useful and efficient tools. Unfortunately, things are not so easy in the postal sector, where only principles are harmonized in the postal European regulatory framework. Even the definition of the mail market may differ from one country to another! So it is more difficult to interpret discrepancies across European operators.

The third source is to be found in reports about operators' stock market rating (if listed), earnings and financial reports provided by *market information sources*. This could be new for academic and/or postal economists. When I learned about telecommunications regulation at ARCEP, I was actually surprised by the important role played by financial analysts. As the regulatory process is technical and time consuming, financial analysts appear to be almost the only observers who understand debates and decisions precisely. In order to understand the companies involved in the postal sector, they use benchmarks such as stock market information. It may also be the case that operators pay more attention to stock rating and investor relations than to regulation! That is why financial analysts of the telecommunications sector can be so well informed and useful. In contrast, very few postal companies, even privatized ones, are listed on stock markets. So, postal analyses are much less well informed than their telecommunications counterparts.

With competition, *innovation* is another dynamic driver of information revelation. Innovation and other disruptive changes create uncertainty for both operators and regulators. The present financial crisis and the drop in mail traffic may also be seen as a powerful incentive to share information. When preparing the Universal Postal Union's 'High Level Conference' in April 2009, operators, although usually reluctant to disclose data, decided to participate in a consolidated report devoted to the 'Impact of the economic crisis on postal activities'. Although no data on specific operators are available in the report, the report reveals that the situation is similar in all countries and is similar to the express industry.

To sum up, competition, international benchmarking, financial analyses, innovation

and drastic contextual changes provide additional incentives to convince incumbents that it would be useful to share more, if not all, information with the regulator. Since regulation is a durable relationship, it could be more costly for incumbents to conceal information, especially if such a practice is discovered. However, information asymmetry is probably much more critical for post than for other markets, such as telecommunications. Certainly, information asymmetry does exist in the latter. But if one compares the information available in the two sectors, respectively, and if one investigates how that information can be checked, it becomes very clear that the postal regulator does not enjoy the same opportunities for getting information as does the telecommunications regulator.

It is difficult to conclude without any reference to the harsh realities of the current period. As in many other markets, the mail market is falling. The trends observed before the financial crisis were already disquieting. On average and since the beginning of the 1990s, traffic growth in industrialized countries has been less than the economic growth rate. Even worse, in most of these countries, traffic has been stagnating since the beginning of the decade. What is worrying in the more recent data is the drop in direct marketing mail. Until the current crisis, that market segment was seen as a growth driver balancing the decline in transactional mail. It remains to be seen whether the recent severe decline in volume will recover after the current economic crisis has passed. Alternatively, it may be that the concurrent impact of the financial crisis and the structural impact of Internet-based electronic substitution will give rise to a permanent and irreversible decline in volume.

Although most problematic, the decline in mail volume is not completely unexpected. More surprising is the invariance that appears between the postal debates of the early 1990s and those of today. Some issues that were at the center of the policy debate, such as quality of international service or terminal dues, are less prominent now. But very central issues, such as USO, the counters network, and their financing, are still open, and not just in Europe. They are at the core of the Postal US Regulatory Commission report and of the 2009 conference program. In the same spirit, the British Hooper report published at the end of 2008 provides an excellent summary of the current regulatory challenges in the UK postal market,³ but it looks just like a younger brother of the British Green Paper published in 1994.

In most other regulated sectors, whether regulation is considered in a positive or negative light, it seems that questions have changed. Why is this not the case in the postal sector? Is it because our answers, as economists, have not been adequate? Or is it because we have not asked the right questions? One thing is clear, however: the level of analysis has improved significantly, fostered by these conferences and the books arising out of them.

NOTES

1. See Bouin, Curien and Lacroix, ch. 6 in this volume for a discussion of the history and structure of the French price cap, which is unique in its approach to adjusting for unanticipated changes in demand or cost, while attempting to maintain strong incentives for efficiency.
2. See Catherine Gallet-Rybak, Cécile Moreno, Daniel Nadal and Joëlle Toledano. 'The French postal market in the wake of the postal law of 2005', in Michael A. Crew, Paul R. Kleindorfer and James I. Campbell Jr. (eds), *Handbook of Worldwide Postal Reform*, Cheltenham, UK and Northampton, MA, USA: Edward Elgar Publishers, 2008
3. Ricard Hopper, 'Modernise or decline: policies to Maintain the universal postal service in the United Kingdom', an independent review of the UK postal services sector, December 2008.