

FINANCING OF UNIVERSAL POSTAL SERVICE IN CONDITIONS OF FULL MARKET LIBERALISATION

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Abstract: *With the full market liberalisation of postal services it is also necessary to establish instruments for financing the net cost of the universal service obligation. In accordance with the third Postal Directive the net cost of the universal service obligation is calculated as the difference between the net cost for the designated universal service provider providing the universal service obligation and the net cost of that same postal service provider when it would operate business without the universal service obligation. Net cost incurred by the obligation of providing universal service is a precondition for the compensation of the cost of the universal service obligation.*

Key words: *universal service, net cost, universal service obligation*

1. Introduction

Liberalisation process of postal services market in the Republic of Croatia was initiated by bringing of Postal Law in 2003 when also formally the monopoly of Croatian Post for letter mail above 100 g was abolished, and by founding of the Council for Postal Services as an independent national regulatory body for postal services. The extent of the universal service was decreased in 2005 by the adoption of Postal Market Development Strategy of the Republic of Croatia until 2013 by the authorised ministry, in which the dynamics of further market liberalisation of postal services in the Republic of Croatia was determined according to the scenario of gradual market liberalisation. The main goal of the application of gradual liberalisation was the preparation of the postal services market in the Republic of Croatia and the public operator Croatian Post for the upcoming full market liberalisation.

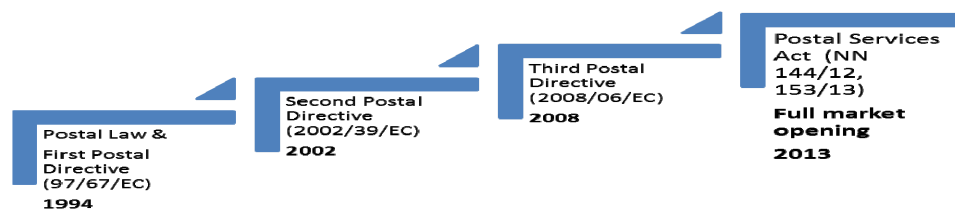


Figure 1 Liberalisation process of postal services in the Republic of Croatia

By bringing the Postal Services Act in 2009 a regulatory framework was established within national legislation, fully aligned with the Second Postal Directive. It was followed by the decrease of the letter mail weight limit in reserved area from 100 g to 50 g, while the price limit was decreased from the threefold price amount for the first weight fastest category to 2.5 times greater amount for that category of letter mail.

The Third Postal Directive was fully implemented by bringing the new Postal Services Act at the end of 2012, which abolished the monopole of the public operator starting from 01 January 2013, i.e. its exclusive right to perform reserved universal postal services.

The foundation of the gradual postal market opening is the bringing of the Directive 97/67/EC, by which the process of development of a single postal services market was initiated. The Directive was preceded by the note of the European Commission on the application of the market competition rule, which announced the opening of the market and the attitude of the EC in relation to market competition in the field of postal services. The amended Directive 2002/39/EC points out the need for gradual and monitored opening of the postal services market for competition, while the last amendment of the Directive in 2008 determined the full development of internal postal services market within EU.

2. Obligation to perform universal postal service

Universal service is defined by the valid Postal Services Act as a group of postal services of defined quality, available at affordable price to all users of postal services in the whole territory of the Republic of Croatia, independent of their location.

The universal service provider is designated by the regulatory agency (HAKOM) on the basis of the analyses of postal services market in the Republic of Croatia, taking into account the principles of objectivity, transparency and non-discrimination. However, if HAKOM based on the analyses of the situation in the postal services market estimates that only one provider of postal services can ensure the provision of universal service in the way and under conditions prescribed by the law, the universal service provider is designated without the need of conducting public bidding procedure.

Thus, by stipulation of Article 67 of the valid Postal Services Act it is determined that Croatian Post is the provider of universal service and that based on law it has the right and obligation to perform the service for the period of 15 years from the date of entering into force of the Act.

3. The mechanism of financing the provision of universal service

Along with the market liberalisation of postal services it was necessary to ensure the conditions for the continuation of provision of universal service. The greatest impediment to its continuation is the way of financing the cost which results from the service provision, since the market liberalisation has abolished reserved area which before liberalisation served for its financing. The financing of the cost of universal service was left to the authorised state bodies to decide and thus each country decides individually on the way or on the combination of ways of cost compensation.

Although in theory there are several possible ways to finance the provision of universal service, the praxis so far has shown that the majority of countries use - more or less satisfactory – mainly two models - compensation fund and/or budget financing.

Croatian Postal Services Act which entered into force on 1 January 2013 i.e. at the same time when the full liberalisation of postal services in the Republic of Croatia was introduced – also favoured the model which is the combination of compensation fund and financing from the state budget.

Compensation fund is founded and managed by the regulatory agency (HAKOM) and the contributions are paid by the universal service provider and the providers of alternative postal services according to HAKOM's calculations. The universal service provider whose calculated contribution to the compensation fund is smaller than the calculated compensation for obligatory performance of universal service does not pay contributions but is paid the difference between the calculated compensation and the calculated contribution. On the other hand, the contribution amount paid by the alternative postal service provider cannot exceed 5% of the income earned from the provision of alternative postal services in preceding calendar year.

In case the contributions to the compensation fund are not sufficient to pay for the whole obligation of financing the unjust burden, the remaining unsettled amount of unjust burden is covered from the state budget of the Republic of Croatia, in accordance with the rules on state subventions.

a. The methodology of net cost calculation of the universal service obligation

If the obligation to perform universal service which creates net cost that represents unjust financial burden for the universal service provider, the universal service provider is entitled to compensation of the determined unjust financial burden. Net cost is each cost necessary for the provision of universal service, which is connected with the service and it is calculated as the difference between the net cost of the universal service provider obliged to perform the universal service and the net cost which the universal service provider would have if it had not the universal service obligation. Based on such calculation the Regulator determines by its decision the amount of net cost which presents the unjust burden, establishes the compensation fund and determines the contributions which should be paid by the universal service provider and alternative service providers.

Therefore the calculation of the net cost of the universal service obligation (USO) must answer the following question: how would the universal service provider perform its business without USO (1) by change in specifications of services which the provider was offering during the USO or (2) by full abolishment of USO services. The fact is that the universal service provider would continue to perform postal service (without the USO limitation) under different conditions and with different palette of services, founded on other grounds (commercial scenario).

Table 1: *Survey of regulations which serve also as the basis for the compensation of net cost*

SOURCE	DESCRIPTION
Directive 97/67/EZ	Definition of universal service and directions for calculating net cost of the universal service
Annex I to the Directive – part A	<i>Definition of universal service obligation</i> Prescribes detailed parameters for the definition of the provision of universal service
Annex I to the Directive – part B	<i>Net cost calculation</i> Provides foundation for determination of parameters for net cost calculation
Annex I to the Directive – part C	<i>Compensation of the net cost of the universal service obligation</i> Principles are prescribed for the establishment of compensation fund which serves to compensate the net cost of the universal service
Postal Services Act	Regulates: <ul style="list-style-type: none"> - Rules for calculating net cost, - Right to compensation for unjust financial burden - Obligations of the regulator, universal service provider and alternative service providers of postal services in relation to net cost compensation - Establishment of the compensation fund
Regulation on the performance of universal service	Determines elements on which the net cost calculation can be based
Instruction for separate accounting and cost accounting and Instruction on calculation and compensation of the net cost of the universal service and the estimation of unjust financial burden	Prescribes ABC methodology for cost separation accounting in Croatian Post Prescribes methodology for calculating the net cost of Croatian Post

4. Unjust financial burden

As already earlier said, if the obligation of providing universal service produces net cost which is unjust financial burden for the universal service provider, the provider is entitled to compensation for the determined unjust financial burden.

For the purpose of calculating net cost, the universal service provider with the universal service obligation must prepare the presentation of its business without the universal service obligation (commercial scenario) taking into account the following:

- net cost is based only on costs associated with the provision of universal service of prescribed quality
- when calculating net cost only following components of the universal service are taken into account:
 - those creating loss for the provider or
 - those generated when the provider operates business at cost conditions which go beyond habitual market competition rules
 - when calculating net cost one should take into account the ensuring of provision of universal service for special users or user groups, where the provider creates loss or which are performed at cost conditions that are not in accordance with common rules of market business (users or user groups which the universal service provider

would not satisfy if in doing business the provider behaved according to market business rules)

- when it is possible to ensure the performance of universal service in conformity with prescribed quality in several different ways, the calculation of net cost is done by taking into account the way which ensures the provision of the universal service of prescribed quality at minimum cost, even in case when the universal service provider has decided to use another way

- the cost of universal service is decreased for all material and non-material benefits¹ to which the universal service provider is entitled on the basis of provision of universal service

- the universal service provider is granted the right to appropriate profit from performing universal service which enables the level of cost effectiveness which the provider would achieve if he had not the universal service obligation

5. Experiences of other countries

Frontier Economics did an investigation during 2012 on experiences of universal service providers and regulatory bodies concerning net cost calculation. The investigation showed that in praxis three main methods of cost calculation are in use:

- *Deficit Approach* (DA), based on separated cost accounting
- *Net Avoidable Cost* (NAC) and
- *Profitability Cost Approach* (PC)

The choice of approach depends on the way of net cost financing, on provider's strategy, market environment and regulatory environment of particular state.

Table 2: *Methods used in net cost calculation of USO*

METHOD	DESCRIPTION
DEFICIT APPROACH	The difference between the sum of losses from individual products which generate loss and sum of profits from individual products which generate profit – data based on data from the cost accounting model
NET AVOIDABLE COST	The sum of losses from processes within universal service, which in this context are composed of elements of service according to different categories (e.g. format, delivery area, kind of sender, mail category...)
PROFITABILITY COST APPROACH	The difference between the profit of the universal service provider operating with USO and without USO in liberalised market. The profitability cost approach can be expressed also as net costs which can be avoided and which are determined by the sum of changes of increased costs and profit changes.

¹ *Material and non-material benefits encompass:*

- *income from universal service as well as income from services which are not part of the universal service and which the universal service provider would not have realised had he not provided universal service.*
- *increase of value of trademarks due to performance of universal service*
- *decrease of costs of provision of other services because of synergy effects which result from performing universal service*
- *other material and non-material benefits determined by the regulatory body*

Main difference between these three methods is presented in Figure 2:

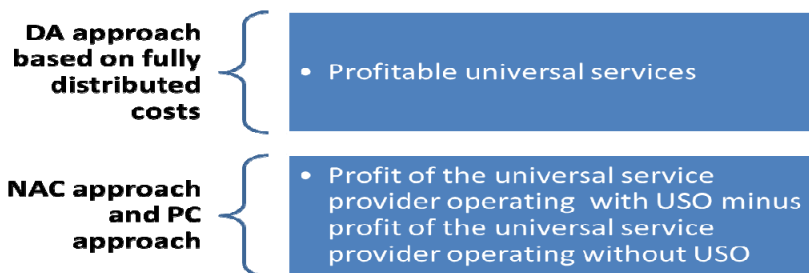


Figure 2: Differences in methods applied in calculating net cost

According to research done by *Frontier Economics*, the European praxis of the concept of unjust financial burden is as follows:

Austria – financial burden is considered unjust if the net cost of the universal service exceeds 2% of the total costs of the universal service provider

Belgium- financial burden is considered unjust if the net cost of the universal service exceeds 3% of the total costs of the universal service provider (including income from universal service)

Czech Republic - financial burden is considered unjust if the net cost of the universal service exceeds 1% of the total costs of the universal service provider

Finland – national regulations determine four criteria for defining unjust financial burden:

- Company's size
- Type of company's business
- Total income from company's sales
- Other indicators of similar nature, which are stated in regulations (e.g.. market share of the universal service provider, his profitability, and capability to pay dividend to shareholders)

Ireland – according to publicly available data by the Irish regulator, financial burden exists if the net cost of the universal service is significant when compared with the implementation and costs of the management of compensation mechanism and if it significantly influences the profitability of the universal service provider, its competitiveness, or both

Hungary – financial burden is considered unjust if the net cost of the universal service exceeds 1% of the costs of the universal service provider resulting from performing universal service.

Norway – the provision of universal service creates unjust burden if the profit which the universal service provider would realise without the universal service obligation is higher than the profit which the provider realises with the universal service obligation.

Slovakia – net cost is calculated in relation to:

- Difference between the net cost (calculation method includes direct and indirect costs) and non-material assets which should be positive
- Absolute difference between the profit of the universal service provider in comparison with the profit of competition
- Level of availability of universal service, its development, financial result and influence on the economic situation of the universal service provider
- Comparisons of absolute level of net cost with incomes of the universal service provider

6. Conclusion

The praxis so far, as well as the numerous problems which the universal service providers face, point to the fact that the number of providers in EU member countries which submit request for the financing of unjust financial burden is increasing. It is believed that this number will further grow and that the compensation for unjust financial burden will become praxis in all member countries of the European Union. Regardless which of the three so far used methods is applied, each of the countries has accommodated it to its particular situation and the praxis points to the fact that the fund (if at all anticipated) is not sufficient for financing the overall universal service obligation which presents the unjust financial burden and that the greater part of the compensation is paid to the designated universal service provider from the budget as subvention.

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**FINANSIRANJE UNIVERZALNE POŠTANSKE USLUGE
U USLOVIMA POTPUNE LIBERALIZACIJE TRŽIŠTA**

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