

**CONSIGNIA'S COMMENTS IN APRIL 2002 ON
"THE IMPACT OF LIBERALISATION ON EFFICIENCY: A SURVEY –
A report prepared for Postcomm by Frontier, January 2002"**

**Paper 2 of a series of papers prepared by Consignia in June
2002 for Postcomm's review of the price control for 2003**

Summary

The main purpose of Frontier's report ("the Report") appears to be to try to demonstrate that liberalisation leads to greater efficiency by inference from other regulated industries in the UK and the postal sector in other countries where full market liberalisation has occurred. In addition, the Executive Summary of the Report states that: "*a reasonable productivity profile for Consignia could be:*

- *15% improvement in the first 18 months (in line with its own projections);*
- *falling to 4% per annum for up to 5 years (in line with experience in other utility sectors); and*
- *perhaps falling to a more modest 2% per annum thereafter in line with general improvements in productivity."*

The Report refers to the performance and, in particular, efficiency improvements of the electricity generation and telecommunication industries after liberalisation. The Report does not consider factors other than liberalisation that could explain, in part or in full, the changes in performance within each sector. Consequently, the Report does not demonstrate a relationship between liberalisation per se and performance or efficiency improvement. It remains ambiguous in the Report whether liberalisation per se in the electricity and telecommunication sectors has led to efficiency improvement and, perhaps more importantly in the context of the conclusions of the Report, the extent to which liberalisation per se has led to efficiency improvement in these sectors and would do likewise in the postal sector.

The Report refers to the performance and, in particular, efficiency improvements of the universal postal provider (the "USP") in Sweden and, more generally, to the performance of the USP in New Zealand post liberalisation. Consignia considers that the Report does not demonstrate a relationship between liberalisation and efficiency or productivity improvements in the postal sector for these countries. It considers that the Report also does not demonstrate that significant entry following liberalisation will not lead to a deterioration in performance and financial viability. It remains ambiguous in the Report whether full liberalisation in the postal sector would lead to efficiency improvement and no deterioration of performance or financial viability relative to that achieved without liberalisation.

Consignia considers that the Report does not present data on a consistent and comparable basis and that this leads to erroneous conclusions. As examples, the Report does not take account of the different costs associated with addressed and unaddressed letter volume

and correct for this difference, the Report overstates the level of productivity in Sweden after liberalisation and the Report understates the level of performance of the UK in terms of letters per employee. There is no recognition in the Report of the issues involved in comparing data over time of one postal operator, or between postal operators in different countries.

The Report does not distinguish clearly between overall efficiency (which should include scale economies from volume growth) and underlying productivity (which should exclude scale economies) and uses the terms interchangeably. Further, it does not correct for volume growth between its references to efficiency and productivity.

Fundamentally, the evidence in the Report does not demonstrate that the profile of productivity improvement proposed for the UK in the Executive Summary of the Report was achieved in Sweden or New Zealand after liberalisation. The Report does not provide credible support for the profile of productivity proposed as achievable for the UK in the Executive Summary.

The Report refers to the productivity in the UK regulated industries of electricity, gas and telecommunication. Consignia considers that the Report: overstates the productivity achieved in the electricity, gas and telecommunication sectors by not correcting for volume growth and economies of scale; relies on comparisons with electricity, gas and telecommunication sectors without consideration of other sectors; and pays no regard to the characteristics of the postal sector that distinguish it from electricity, gas and telecommunication sectors. Consequently, Consignia considers that the Report overstates the productivity profile for the UK mails business of Consignia into the future. The Report again provides no credible support for the profile of productivity proposed as achievable for the UK in the Executive Summary.

There are very significant errors made in the representation of the performance and productivity of the UK inland mail business within the Report. Published data needs to be handled with more care than that presented in the Report. Corrections to the published UK data are needed to ensure that any time series comparison is made on a consistent basis. The complexity of comparative analysis is further magnified when making comparisons of postal operators in different countries. There is no recognition of these issues within the Report and thereby the Report could lead a reader into a false sense of security over the data used and its conclusions. It is surprising that Postcomm did not require the authors of the Report to allow Consignia to comment on the facts presented in the Report before its publication and that a consultant was willing to publish a Report containing so many misleading analysis and misinformed conclusions.

1. Introduction

This paper sets out Consignia's comments on the report entitled: "*The impact of liberalisation on efficiency: a survey - a report prepared for Postcomm by Frontier, January 2002*" (the "Report") which was placed on the Postcomm's Web-site along with Postcomm's proposal document for liberalisation of the UK mails business.

The paper comments on each chapter of the document relating to: "the impact of liberalisation – rationale and empirical evidence" in section 2; "the impact of liberalisation in the postal sector" in section 3; and "the impact of other policy shocks" in section 4. The main focus of these comments relates to the evidence and analysis presented in these chapters in support of the main conclusions set out in the Executive Summary of the Report and in particular the statement that "*a reasonable productivity profile for Consignia could be:*

- *15% improvement in the first 18 months (in line with its own projections);*
- *falling to 4% per annum for up to 5 years (in line with experience in other utility sectors); and*
- *perhaps falling to a more modest 2% per annum thereafter in line with general improvements in productivity."*

Consignia finds that the Report does not present evidence or analysis to support its conclusions and, in particular, its conclusions relating to the future productivity profile for Consignia. Where appropriate Consignia refers to some of its own evidence and analysis. In addition to this response, a separate paper¹ is submitted to Postcomm as part of the current price control review. Consignia considers that paper to also be relevant to Postcomm's liberalisation proposals and the accompanying documents of which the Report forms a part.

¹ "*The Performance of the UK inland mails business of Consignia*", Consignia, June 2002.

2. Comments on “Chapter 2: Impact of liberalisation – rationale and empirical evidence”

2.1 Introduction

The Report commences with analysis that seeks to demonstrate that the full liberalisation of a market and the development of competitive markets outside of the postal sector in the UK has led to efficiency improvements that exceed the levels of efficiency in non-liberalised markets. The Report presents plots of the performances of:

- PowerGen and National Power, two fossil fuel generation companies in the electricity sector established at the time of privatisation, in terms of installed capacity per employee over the period from 1990/91 to 1993/94 and 1997/98²;
- Nuclear Electric, a nuclear generation company in the electricity sector established at the time of privatisation, in terms of installed capacity per employee over the period from 1990/91 to 1993/94;
- British Telecommunications (BT), in terms of the average number of employees from 1984/85 to 1994/95.

Chapter 2 of the Report also makes passing reference to the gas sector.

2.2 National Power and PowerGen

The start of the 1990s saw significant change within the electricity sector, including a change in energy policy to allow natural gas to be used for bulk electricity generation, the establishment from the Central Electricity Generation Board of two fossil-fuel generators of National Power and PowerGen and the transmission company of National Grid Company and the establishment of a trading market (the UK Pool).

Over the period from 1990/01 to 1996/97 National Power and PowerGen reduced their combined generation capacity by about 5.5GW³ of obsolete oil-fired and open cycle gas-turbine generation stations and commissioned about 5.6GW⁴ of new combined-cycle gas turbines. The substitution of the obsolete technology with new technology reduced labour input and thereby improved the measure of “megawatt capacity per employee”.

Over the same period about 15.5GW⁵ of new generation was commissioned. This was dominated by the development of CCGT power stations. The CCGT power

² Consignia notes that Figures 1 and 2 of the Report present consecutive data for 1990/91 to 1994/95 and then 1997/98, without reference to the years 1995/96 and 1996/97. This somewhat bizarre and cavalier approach to the graphical presentation of time series data could give the impression to a reader that the rate of improvement in megawatt capacity per employee continued to increase when in fact the rate of improvement declined after 1994/95.

³ Table 3.10, Seven Year Statement”, the National Grid Company, 1997.

⁴ Table 3.8(a), Seven Year Statement”, the National Grid Company, 1997.

⁵ Table 3.8(a), Seven Year Statement”, the National Grid Company, 1997.

stations operated in base load. This reduced the operation of existing power stations under the ownership of National Power and PowerGen. The change in operation, caused by the development of CCGT, enabled changes to be made in shift work, reduced labour input and thereby improved the measure of “megawatt capacity per employee”.

Over the period from 1990/91 to 1997/98 the UK Pool did not operate as an effective competitive market. National Power and Power Gen operated as an effective duopoly in the UK Pool. There was regulatory intervention to cap generation prices, numerous regulatory reviews and ultimately proposals to replace the UK Pool.

Consignia considers that a reader of the Report could easily be misled into believing that liberalisation per se, through the establishment of the UK Pool market, was the key factor in the improved megawatt capacity per employee during the period 1990/91 to 1997/98. In contrast, Consignia considers that technological change and changes in energy policy over the production of electricity were significant contributors to the change in “megawatt capacity per employee” for which there is no obvious parallel in the postal sector.

2.3 *Nuclear Electric*

In 1990/91 and subsequent years, Nuclear Electric received financial support through a subsidy from UK electricity sales. The Government proposed to reduce this subsidy over time to enable Nuclear Electric to be sold at a later date. In addition, Nuclear Electric commissioned a 1.5MW PWR nuclear power station at Sizewell B in 1994. During the period 1990/91 to 1993/94, Nuclear Electric was in the construction phase of Sizewell B. Over the construction period, the employee numbers increase and then decline.

Consignia considers that a reader of the Report could easily be misled into believing that liberalisation per se, and in particular the establishment of the UK Pool market, was the key factor in the improved megawatt capacity per employee during the period 1990/91 to 1993/94. In contrast, Consignia considers that the construction of Sizewell B and the pressure to reduce the subsidy to Nuclear Electric were significant contributors to the change in “megawatt capacity per employee” for which there is no obvious parallel in the postal sector.

2.4 *British Telecommunications*

In its presentation of BT, the Report makes reference to the duopoly market of BT and Mercury as a major contributor to the numbers of employees remaining relatively stable between 1984/85 and 1989/90. However, the Report makes no reference to outsourcing and does not consider the change in overall operating costs over the period.

In contrast, in its presentation of the electricity sector in Chapter 2 of the Report, the Report makes no mention of the presence of the duopoly in electricity

generation. However, the Report does make reference to the unlikelihood of the efficiency improvement being attributed to outsourcing.

In addition, there has been a significant substitution of labour by capital over the period with the introduction of new technology. For example, the installation of successive generations of new electronic exchanges and new optical fibre and microwave transmission networks has resulted in significant reductions in operating costs.

Consignia considers that the Report does not give a consistent and balanced presentation of the sectors under analysis. Consignia also considers that the reduction in the numbers for BT after 1989/90 would be consistent with a change in company policy towards outsourcing and opportunities arising from technological change. These were significant contributors to the change in the average number of employees for which there is no obvious parallel in the postal sector.

2.5 Summary

Chapter 2 of the Report concludes that liberalisation has “a powerful effect” on efficiency. The Report does not consider factors other than liberalisation that could explain, in part or in full, the change in efficiency within each sector. Consignia identifies several factors that could account for the changes in efficiency and should have been considered in the Report. Overall, the Report does not demonstrate at all a relationship between liberalisation per se and efficiency improvement. It remains ambiguous in the Report whether liberalisation per se in the electricity and telecommunication sectors has led to efficiency improvement and, perhaps more importantly in the context of the main conclusions in the Report, the extent to which liberalisation per se has led to efficiency improvement in these sectors.

Consignia considers that the Report is presented in a manner that could mislead the reader. Fundamentally, it could mislead a reader to believe that liberalisation per se will lead to efficiency improvements akin to that presented for National Power, Power Gen, Nuclear Electric and BT with the inference that this is equally applicable to the postal sector. Consignia considers that the Report does not establish on any basis of fact a relationship between liberalisation and efficiency improvement *in the postal sector*.

3. Comments on “Chapter 3: Impact of liberalisation in the postal sector”

3.1 Introduction

Chapter 3 of the Report states that: “*the focus of this section is on the relationship between liberalisation and efficiency*”⁶. The chapter includes a comparison of the performance of Sweden Post (the USP in Sweden) since 1986 with a particular focus on the performance since 1993 when full liberalisation was introduced. It also includes a brief review of the performance of the USP in New Zealand.

Overall, the presentation of the Report implies that full liberalisation leads to greater efficiency in terms of increased letters per employee and reduced costs per letter relative to that with non-liberalisation. The Report also concludes that full liberalisation has occurred without a deterioration in the financial viability of the postal companies or the performance against the service specification.

3.2 Comparative analysis: UK

In the mails business of the postal sector, letters or mail items per employee over time has been used as a measure of performance. The Report shows letter items per employee using mail items (including both unaddressed and addressed mail) and company-wide Full-time Equivalent (FTE) employee numbers from the Annual Reports and Accounts.

When comparing mail item per employee over time it is necessary to ensure that the measures of volume and employees are made on a consistent basis. This requirement applies to postal services from all postal operators.

The UK inland mails business of Consignia (excluding Parcels and Post Office Ltd) from 1987 to 1998 has data on the measure of letter items per employee based on:

- employee numbers on a Full Time Equivalent (FTE) in the mails business where an adjustment is made to full time work hours to take account of part-time work⁷; and
- volume of addressed letter mails. The labour required to handle addressed letter items are much higher than that needed for unaddressed mail.

Corrections to the published figures of the UK inland mails business are required to place the data on a consistent basis over the period 1987 to 1998. In terms of

⁶ Extract from the introduction to Section 3 of the Report.

⁷ An alternative approach, using an index of gross hours to measure the change in employee numbers for the period 1989/90 to 1999/00 is included in: “*The performance of the UK inland mails business of Consignia*”, Consignia, June 2002.

Consignia's data on the employee numbers, as published in the Annual Report and Accounts of the Company, the following should be noted:

- i. before 1994/95, full-time staff were counted as one employee and part-time staff as a half an employee, regardless of actual hours worked or contracted. In 1994/95 a revised definition was used and increased the number of reported staff by 4,000 (2.7 per cent). To construct a consistent time series an "adjusted FTE" data series requires the reported figures for years before 1994/95 to be increased by 2.7 per cent;
- ii. in 1998/99 the Annual Report and Accounts used the pre-1994/95 measure of FTE. A correction is therefore made, from a comparison made on a consistent basis between the two years, to place the 1998/99 data on a consistent basis with the figures for the previous years.

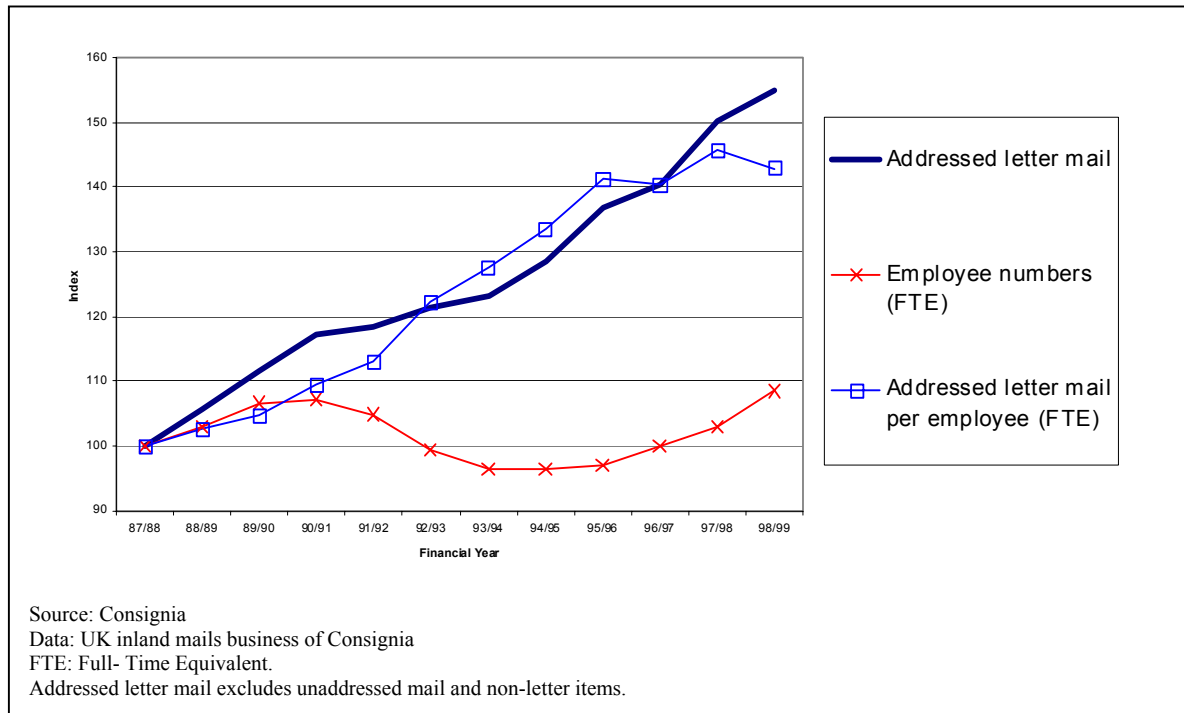
In terms of Consignia's data on the mail volumes, as published in the Annual Report and Accounts, the following should be noted:

- i. in 1998/99 the Annual Report and Accounts addressed letter mail volumes were revised downwards after surveys indicated the proportion of higher weight/higher value items had previously been understated. The Accounts reported volumes on the new basis for each year since 1994/95. The corrected volume for 1994/95 was 10 per cent less than the previously reported figure. To obtain a consistent data series back to 1987/88 that takes account of this discontinuity in the reported figures, the reported volumes for 1987/88 to 1993/94 need to be reduced by 10 per cent;
- ii. trend analysis is distorted by the effect of strike action on traffic volumes in 1996/97 and 1988/89. No adjustment has been estimated for 1996/97. However, the volumes in 1988/89 should be adjusted by +4 per cent to reflect an internal estimate of the strike's impact;
- iii. the published volume figures also distorted by different numbers of working days in each financial year, particularly the "53 week" years in 1989/90 and 1995/96. Hence volume figures should be corrected for the number of working days.

Figure 1 shows the indices of addressed letter mail volume, employee numbers (FTE) and addressed letter mail per employee for the UK inland mails business of Consignia from 1987/88 to 1998/99 with the above corrections necessary to prepare time-series data that are reasonably consistent over time⁸. Figure 1 shows a steady improvement in the measure of addressed letter mail per employee over the period.

⁸ A graph of addressed letters per employee for the period 1989/90 to 1999/00 is included in the separate paper entitled "*The Performance of the UK Inland mails business of Consignia*" Consignia, June 2002. In that paper, the measure of employee numbers is based on gross hours worked as the present measure of employee numbers used by Consignia's UK inland mails business.

Figure 1: The indices of addressed letter mail volume, employee numbers (FTE) and addressed letter mail per employee for the UK inland mails business of Consignia from 1987/88 to 1998/99



Though these corrections are related to the UK inland mails business of Consignia, the Annual Report and Accounts reports volume of addressed mail for the UK inland mails business and a company-wide FTE figure. Consequently the corrections are equally applicable to the UK company-wide figures.

The corrections to the data reflect the complex issues around ensuring that available data is on a comparable and consistent basis for one postal operator. As set out in section 3.3 below the issues become further magnified when making comparisons of postal operators in different countries. There is no recognition of these issues within the Report and thereby the Report could lead a reader into a false sense of security over the data used and its conclusions.

3.3 Comparative analysis: UK and Sweden

Figures 10 and 12 of the Report compare the letters per employee for the UK with those of other countries, including Sweden, from 1986 to 1999. The plot for Sweden is shown separately in Figure 5 of the Report and relates to (a) a measure of letters that includes unaddressed letter, addressed letters and non-letter items and (b) a measure of employee numbers based on Group FTE figures in the Annual Report and Accounts. Consequently the figures are not directly comparable with those in section 3.2 above.

Consignia considers that it is essential, when making comparisons of performance measures over time, for data to be consistently measured or, if necessary, corrected to place it on a consistent and comparable basis. It also considers that

an international comparison of letters per employee should take account of a number of factors including the following:

- i. *the level of data within the company*: e.g. not all postal service employees within the USPs are employed on letter services or on overhead activities associated with them; some, for example, may be working on parcels or banking services.
- ii. *the composition of the product mix*: e.g. addressed and unaddressed mail - the work required for an item of unaddressed mail is substantially less than for an addressed item; worksharing – the extent to which parts of the mails process (e.g. sortation) are undertaken by parties other than the USP; and different handling characteristics - the extent of bulk mail items such as periodicals and newspapers (which are particularly significant in some countries).
- iii. *geographical and economic factors*: e.g. the size and terrain of country; size and pattern of settlement, commercial centres and transport infrastructure.
- iv. *customer factors*: e.g. service specification - including planned time of delivery, number of deliveries per day and number of days for delivery.
- v. *product characteristics*: e.g. range of products and service quality.
- vi. *volume of mail in total and per household*: the extent of economies of scale is affected by these components, e.g. volumes per household are linked to the level of gross domestic product of the country.

Consignia considers that the Report has not corrected for these factors. For example, the data used in the Report and Figures 5 and 12 for Sweden includes unaddressed mail volumes. However, unaddressed letter mail has much lower costs per item than addressed letter mail and formed a significant part of Sweden's mail volume growth during the 1990s. The data presented in Figures 5 and 12 do not show the letter mail volume per employee on a comparable and consistent basis. It is thereby misleading and leads to erroneous conclusions within the Report.

Consignia has undertaken a comparison of the letter mail per employee for the UK and Sweden in 1998, 5 years after full liberalisation in Sweden. The comparison takes account of many more of the factors identified above than that undertaken in the Report. The comparison used addressed letter mail to measure letter volume and company-wide FTE employee numbers to measure employee numbers. The focus on addressed letter mail items arises from the cost per item and volumes for addressed letters being significantly greater than those of unaddressed letter mail. The company-wide FTE employee numbers are available from the company accounts of the postal operators.

The comparison assessed the adjustment to the ratio of letter mail per employee for Sweden necessary for a like-for-like comparison with the UK taking into account the effect on the separate postal functions of collection, distribution, sortation and delivery as well as an overall average. On this basis the ratio of addressed letter mail per employee for Sweden was increased for distribution and collection and reduced for delivery, sortation and overall.

Table 1: Comparison of letter mail volumes (000s) per company-wide FTE employee for Sweden and the UK in 1998

Country	Uncorrected addressed <i>and</i> unaddressed letter mail per employee	Uncorrected addressed letter mail per employee	Corrected Addressed letter mail per employee
Sweden	119.3	77.8	68.5
UK	105.8	95.7	95.7

The overall results are summarised in Table 1. The uncorrected ratio of addressed *and* unaddressed letter mail per employee for Sweden, at 119,000 was more than the equivalent figure of 105,800 for the UK. However, the uncorrected ratio of addressed letter mail per employee for Sweden, at 77,800 was significantly less than the equivalent figure of 95,700 for the UK. The corrected ratio of addressed letter mail per employee at 68,500 for Sweden was significantly less than the equivalent ratio at 95,700 for the UK. This result is in stark contrast to that shown in the Report⁹.

Consignia has extended the comparison in Table 1 to compare the change in corrected addressed letter mail per company-wide FTE employee between 1993 and 1998 for Sweden and the UK. The results are shown in Table 2. The figure for Sweden increased by 3.5 per cent per annum and that for the UK increased by 4.0 per cent per annum between 1993 and 1998. Hence, in contrast to the conclusions drawn in the Report and in particular the plots for UK and Sweden in Figures 10 and 12, these results indicate that the performance of the mails business in the UK was similar to, and in fact marginally exceeded that of, Sweden between 1993 and 1998 – the period after liberalisation in Sweden (1993).

⁹ As used in the Report the analysis used company-wide FTE data. The Report did not consider a comparison of addressed letter mail per mails business FTE employee numbers. The FTE employee numbers for the mails business of Sweden Post as a proportion of company-wide FTE employee numbers may be lower than that in the UK. Since the precise functions of separate businesses may differ between companies, it is not straight-forward to adjust the above analysis from addressed letters per company-wide FTE employee numbers to addressed letters per mails business FTE employee numbers. Having reviewed the available information, Consignia can confirm that though such an adjustment may reduce the differential in the performance measure shown in Table 1, a measure of addressed letters per mails business FTE employee numbers would still remain higher in the UK than in Sweden.

Table 2: Comparison of corrected addressed letter mail (000s) per company-wide FTE employee for Sweden and the UK between 1993 and 1998

Country	1993	1998	Change per annual %
Sweden	57.6	68.5	3.5
UK	77.9	95.7	4.0

The analysis could be extended from addressed letter mail per FTE employee numbers to operating costs per addressed letter mail. Such analysis is complicated by the treatment of operating costs and one-off costs within the accounts of the companies – and particularly so at the company-wide level presented for Sweden in Figure 6 of the Report. The Report does not undertake such an analysis and neither does this response. However, a comparison of the price per letter for the basic weight step (below 20 grams) and average below 60 grams in 1998, indicates that the price in the UK was 26 pence per letter for below 20 grams and below 60g alike. In comparison, the price in Sweden was equivalent to 36.4 pence per letter below 20 grams and 46.7 pence per letter below 60 grams. Even, with the exclusion of a 25 per cent VAT surcharge from the prices in Sweden, the prices in UK were significantly less than the comparative prices in Sweden. This was also the case in 1993. This would suggest that the operating cost per addressed letter mail in Sweden was greater than that in the UK over the period from 1993 to 1998.

Consignia concludes from this analysis that:

- Sweden had a low level of efficiency and performance relative to the UK in the late 1980s. During the period to 1998 Sweden may have tried to catch up some of the ground with the UK, but whether it did or not is not demonstrated in the Report. The results of Consignia’s analysis indicate that, by 1998 and on a comparable basis, Sweden was still less efficient than the UK;
- the analysis of the Report does not demonstrate that the efficiency improvement during the period in Sweden is attributed to liberalisation per se. The results of Consignia’s analysis indicate that, between 1993 and 1998 and on a comparable basis, the improvement in addressed letter mail per employee was similar, and in fact marginally greater, in the UK relative to Sweden;
- since the level of performance was already higher in the UK than in Sweden, the performance improvements in Sweden during this period do not indicate the level of efficiency improvement or productivity that are readily available for the future in the UK.

3.4 *Productivity in Sweden and New Zealand*

The Report concludes from Figure 5 of the Report that the average annual “productivity” growth was 6 per cent in Sweden from 1993 to 1995. Consignia considers that addressed letter mail per FTE employee can be an indicator of performance. The previous subsection has indicated the relative performance of Sweden and the UK, in terms of addressed letter mail per FTE employee for the period 1993 to 1998. However, this is a measure of overall performance rather than productivity.

Overall efficiency relates to the improvement in unit costs over time and includes economies of scale from volume growth that should be excluded to derive the measure of underlying productivity. While the measure of letter mail per employee may have improved by about 6 per cent per annum in Sweden between 1993 and 1995, when corrected for economies of scale and costs the level of productivity would be significantly less than 6 per cent per annum. In addition, if the period was extended to 5 years (i.e. 1993 to 1998), the underlying level of productivity would reduce significantly. As indicated in subsection 3.3, the performance of the UK inland mails business exceeded that of Sweden Post in terms of comparative addressed letter mail per employee over this 5-year period.

In Section 3.1 of the Report there is a brief review of the performance of New Zealand Post over a period of deregulation commencing in 1989 and completed in 2000. The consultants did not have comparative data for the whole period and, consequently, did not assess the level of productivity in New Zealand.

The Executive Summary of the Report states that “*a reasonable productivity profile for Consignia could be:*

- *15% improvement in the first 18 months (in line with its own projections);*
- *falling to 4% per annum for up to 5 years (in line with experience in other utility sectors); and*
- *perhaps falling to a more modest 2% per annum thereafter in line with general improvements in productivity.”*

The evidence in the Report does not demonstrate that this profile of productivity improvement was achieved in Sweden or New Zealand. Chapter 3 of the Report does not substantiate the conclusions made in the Executive Summary.

3.5 *Comparative service performance*

Section 3.2 of the Report includes a graphical presentation of the performance against the service specification in each country for delivery by the next day from 1993 to 1999. The Report concludes that “*Sweden has consistently kept a higher level of quality of service, with the exception of 1996, when percentage of letters delivered the next day were slightly below the Netherlands.”* The Report also

concludes that: *“faster liberalisation has not led to any deterioration in quality of service, compared to countries that have liberalised more slowly.”*

Consignia considers that there is no recognition in the Report that different countries have different service specifications, even for ‘next day’ delivery. For example, in the UK the first delivery is scheduled for completion by 9:30am and the second delivery before mid-day. In contrast, in most European countries, including Sweden, delivery is scheduled throughout the day. This allows more mail in those European countries to arrive at the local delivery office, and thereby a higher percentage of mail to be delivered, by the end of the ‘next day’. Conversely, the UK service specification means that a higher percentage of mail is delivered by mid-day of the ‘next day’ than in most European countries.

It is thoroughly misleading to present the absolute levels of service performance for countries, as referred to in the Report, without reference to the different service specifications. Consignia considers that Figure 11 and statements such as *“Sweden has consistently kept a higher level of quality of service, with the exception of 1996, when percentage of letters delivered the next day were slightly below the Netherlands”* are vacuous. There is no recognition within the Report of the need to take account of a number of factors, including differences in service specification, when considering absolute measure of performance between countries.

It is mis-leading to compare service performance in Figure 11 of the Report without reference to the comparative price of the product. Figure 2 shows a comparison of prices across Europe and other leading OECD¹⁰ countries, for the products most closely relating to the UK First Class public tariff mail and a domestic letter of up to 20 grams, relative to the price of inland UK First Class public tariff mail for 2001. Figure 3 shows the corresponding comparison between 20 and 50 grams¹¹.

Figure 2 shows that the price of inland UK First Class public tariff mail is amongst the lowest in Europe below 20 grams and the lowest price for 20 to 50 grams. For mail below 20 grams, when compared to the countries represented in Figure 11 of the Report (i.e. Finland, Germany, Sweden and the Netherlands), the comparative price in Finland, Germany and Sweden is greater than that in the UK. Consignia notes that the comparative prices for mail below 20 grams in the Netherlands and the UK are similar. The service performance against the respective country’s service specification in Figure 11 of the Report is greater in the Netherlands, but the service specification is lower in the Netherlands relative to the UK (as discussed above). Figure 3 shows that the price of a 20 to 50 gram letter in Sweden is twice the price in the UK. Even, with the exclusion of a 25 per cent VAT surcharge from the prices in Sweden, the prices in UK are lower than the comparative prices in Sweden.

Finally, the Report concludes that: *“faster liberalisation has not led to any deterioration in quality of service, compared to countries that have liberalised*

¹⁰ Organisation for Economic Cooperation and Development.

¹¹ These comparisons use estimates of purchasing power parities published by the OECD.

more slowly.” Consignia considers that the liberalisation in Sweden has not led to significant entry. The impact of faster liberalisation with significant entry on the financial viability of Sweden Post and its service standards has not been tested. It remains ambiguous in the Report whether significant entry after full liberalisation will lead to a deterioration of performance by the USP and it is disingenuous not to have stated this clearly in the Report.

Figure 2: A comparison of price across Europe and some developed countries for a domestic letter of up to 20 grams relative to the price of inland UK First Class public tariff mail for January 2002

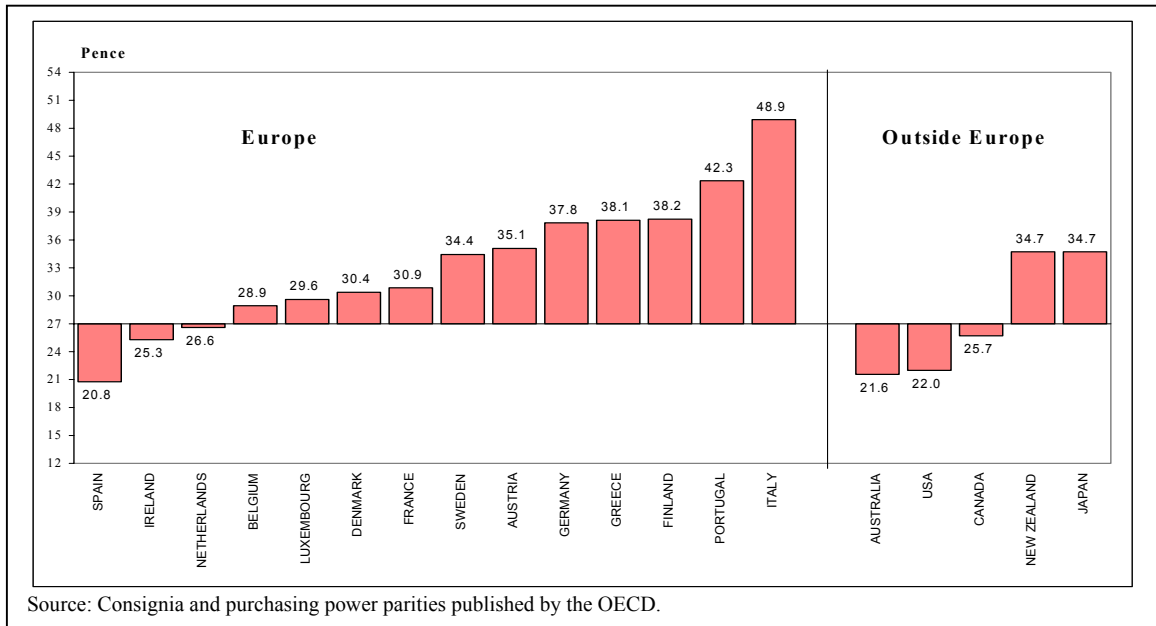
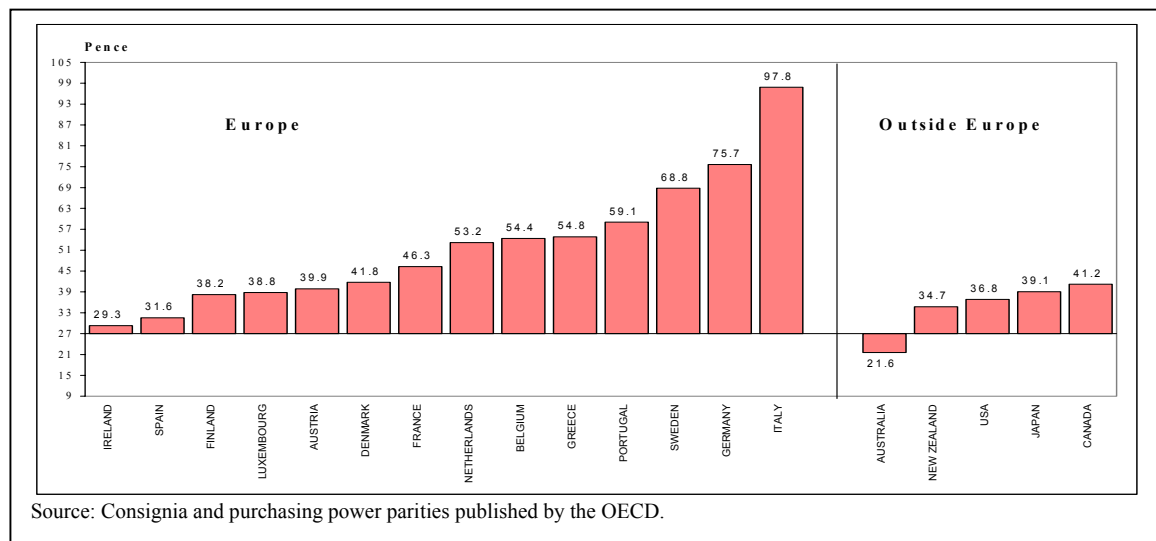


Figure 3: A comparison of price across Europe and leading OECD countries for a domestic letter of 20 to 50 grams relative to the price of inland UK First Class public tariff mail for January 2002



3.6 *Financial viability*

Section 3.12 of the Report states that “*the evidence suggests again that liberalisation is associated with a reduction in profitability, but NZP [New Zealand Post] like Sweden Post, has remained profitable after the introduction of full liberalisation*”.

Consignia considers that this statement is made without any reference to the pricing policy or approach to liberalisation in the two countries. There has been an aggressive, and in some cases anti-competitive, reduction of prices in markets where entry has occurred combined with significant increases in prices for public tariff consumers where entry has either been very limited or non-existent. These price increases have helped maintain financial viability.

With limited entry and loss of volumes to entrants there has been only a limited reduction in revenue for the USPs. Therefore, the cases of New Zealand and Sweden do not indicate the impact on the financial viability of the USP with significant entry or with significant pricing and operating constraints on the USP - both of these conditions being clearly envisaged in its proposals by Postcomm. It remains ambiguous in the Report whether significant entry after liberalisation will lead to a deterioration of financial viability of the USP and it is in disingenuous not to have stated this clearly in the Report.

3.7 *Summary*

The introduction of Chapter 3 of the Report states that “*the focus of this section is on the relationship between liberalisation and efficiency*”¹². The summary of the Report states that “*this Section lends support to the view that liberalisation in Sweden was associated with significant improvements in efficiency, both in absolute terms, and relative to the performance of other operators who faced less competitive environment.*”

Consignia considers that the main conclusions made in Chapter 3 of the Report are not substantiated in either the analysis or text of the Report. It remains ambiguous in the Report whether there is any relationship between liberalisation and performance or efficiency improvements in the postal sector and whether significant entry from full liberalisation would lead to efficiency improvement and no deterioration of performance and financial viability relative to that achieved without liberalisation.

Consignia considers that the Report does not present data on a consistent and comparable basis and this leads to erroneous conclusions. As examples, the Report does not take account of the difference in costs between addressed and unaddressed letter mail volume and correct for this difference; the Report overstates the level of productivity in Sweden after liberalisation; and the Report

¹² Extract from the introduction to Section 3 of the Report.

understates, by a significant margin, the level of performance of the UK in terms of letter mail per employee. There is no recognition in the Report of the issues involved in comparing data over time of one postal operator, or between postal operators in different countries.

The Report does not distinguish clearly between overall efficiency (which should include scale economies from volume growth) and underlying productivity (which should exclude scale economies) and uses the terms interchangeably. Further, it does not correct for volume growth between its references to efficiency and productivity. There is also no comparison of price levels across USPs in the Report which is a significant and readily available measure of performance and efficiency.

Fundamentally, the evidence in the Report does not demonstrate that the profile of productivity proposed for the UK in the Executive Summary was achieved in Sweden or New Zealand after liberalisation. The Report does not provide credible support for the profile of productivity proposed as achievable for the UK in the Executive Summary.

4. Comments on “Chapter 4: The impact of other policy shocks”

4.1 Introduction

Chapter 4 of the Report considers the impact of regulation and ownership on performance. The latter is discussed in the context of a change from public to private ownership. Since this is not proposed for the postal sector Consignia makes no comment on this part of the Report.

On the subject of the impact of regulation, the Report concludes that:

- i. For transmission and distribution in gas and electricity and telecommunication: *“overall, X factors applied by other regulators are broadly consistent with annual price reductions of between 2% and 6% for provision of a constant level of quality of service.”*
- ii. *“Excluding the Transco data, and considering the impacts of quality improvements in the water and telecoms sectors, these utilities have generally achieved average reductions in unit costs (excluding capital costs) of between 4% and 10% per year.”*
- iii. The medium term overall unit cost reduction relative to RPI for a group of regulated industries is estimated to be between 2% and 7% per annum.
- iv. *“The performance of the regulated businesses are not far out of line with that achieved by companies in a liberalised environment.”*
- v. Though not explained or referred to in the text of the Report, the Executive Summary of the Report states that *“a reasonable productivity profile for Consignia could be:*
 - *15% improvement in the first 18 months (in line with its own projections);*
 - *falling to 4% per annum for up to 5 years (in line with experience in other utility sectors); and*
 - *perhaps falling to a more modest 2% per annum thereafter in line with general improvements in productivity.”*

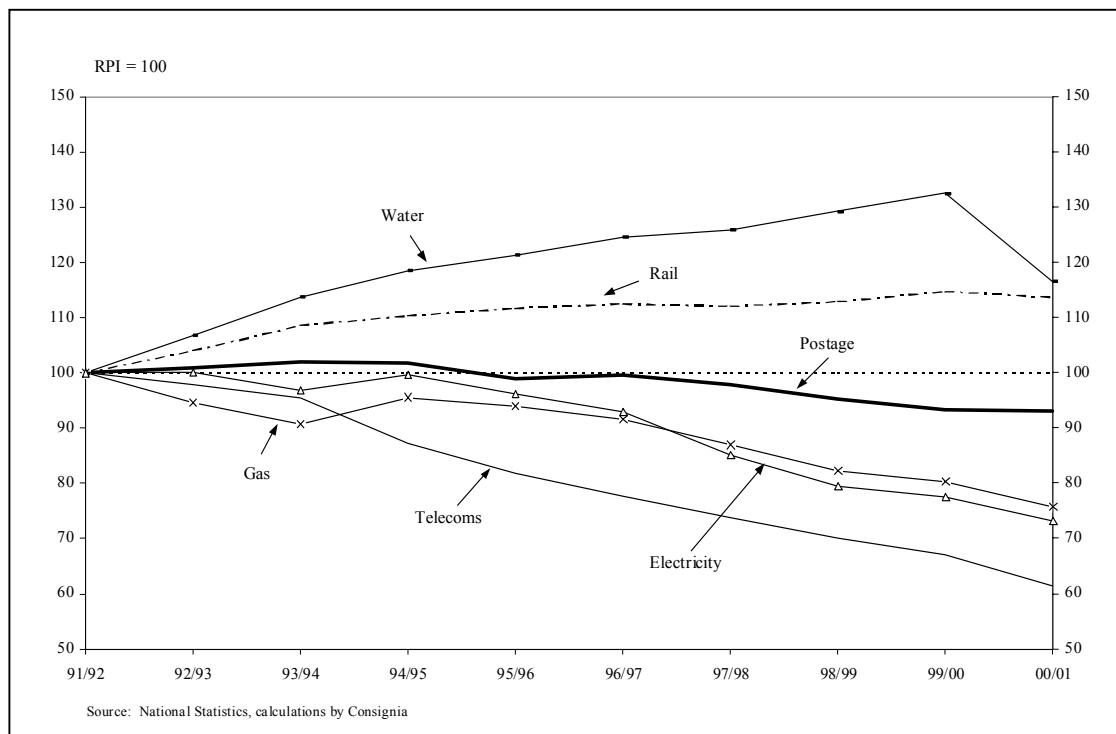
4.2 The efficiencies of other regulated industries

In Figure 4 the movement in the price of postal sector is compared with those in other regulated industries over the last decade. This comparison uses the Retail Price Index figures published by National Statistics for several industries

including the postal¹³, electricity, gas, rail, telecommunication and water. Figure 4 shows that the postal sector price index has reduced by 7 per cent in real terms over the last 10-year period. In comparison, there has been a greater real price reduction in electricity, gas and telecommunication and real price increases in water and rail. There are significant differences across the regulated industries.

The postal sector has, amongst other factors, relatively low volume growth when compared to telecommunication, low investment relative to water and rail and low capital input relative to all regulated industries including electricity and gas. The profile of the postal sector price index in Figure 4 is between the profiles of the indices for, on the one hand, rail and water, and on the other hand, electricity, gas and telecommunication. The postal sector indices reflect a balance of improved efficiency, achieved in part through economies of scale from increased mail volumes, and relatively stable service performance.

Figure 4: Real price indices for postal, electricity, gas, rail, telecommunication and water over the last 10 years



The Report concludes that the “overall, X factors applied by other regulators are broadly consistent with annual price reductions of between 2% and 6% for provision of a constant level of quality of service” from the electricity, gas and telecommunication sectors. It concludes that the productivity in these sectors has been between 2 and 7 per cent per annum. It also concludes that: “Excluding the Transco data, and considering the impacts of quality improvements in the water

¹³ For the postal sector, the index includes, not only, the inland UK First and Second Class public tariff mail, but also international mail, parcels, postal orders, recorded delivery and special delivery. The index reduces more sharply for the First Class and, in particular, the Second Class public tariff than the overall postal price.

and telecoms sectors, these utilities have generally achieved average reductions in unit costs (excluding capital costs) of between 4% and 10% per year.”

Consignia considers that the underlying level of productivity in the other regulated sectors is less than the 2 to 7 per cent stated in the Report. The efficiency levels need to be corrected for volume growth and economies of scale to derive the underlying productivity. The levels of productivity are therefore overstated in the Report.

Consignia considers that the Report has limited its productivity comparators to regulated industries and, further, to those regulated industries with price profiles below that of the postal sector in Figure 4. It considers that the comparators outside of these regulated industries should also have also been considered. Consignia considers that the Report is unbalanced in its sampling within the regulated industries and its exclusion of other sectors.

Consignia considers that the analysis in Chapter 4 of the Report is made without any consideration of the postal sector. The Report does not consider or take account of the differences between the postal sector and the sectors of electricity, gas and telecommunication sectors. These differences include, but are not limited to, the volume growth, capital intensity and the labour intensive nature of the postal sector.

An estimate of the productivity of the UK inland mails business for the UK can be made, using total factor productivity analysis, from a weighted average of productivity factors from appropriate comparators. This is examined further in a separate paper¹⁴, where the results are shown to be similar to the actual productivity level of about 1 per cent achieved by the UK inland mails business of Consignia. This highlights the inadequacy of the analysis in the Report that only takes account of the performance of some other regulated industries.

4.4 Summary

The Report concludes that the electricity, gas and telecommunication industries have achieved levels of productivity of 2 to 7 per cent. The Executive Summary of the Report then concludes that: *“a reasonable productivity profile for Consignia could be:*

- *15% improvement in the first 18 months (in line with its own projections);*
- *falling to 4% per annum for up to 5 years (in line with experience in other utility sectors); and*
- *perhaps falling to a more modest 2% per annum thereafter in line with general improvements in productivity.”*

¹⁴ “The Performance of the UK inland mails business of Consignia”, Consignia, June 2002.

Consignia considers that the Report overstates the productivity achieved in the electricity, gas and telecommunication sectors by not correcting for economies of scale; relies on comparisons with electricity, gas and telecommunication sectors without consideration of other sectors; and pays no regard to the characteristics of the postal sector which distinguish it from electricity, gas and telecommunication sectors. Consequently, Consignia considers the Report overstates the productivity profile for the UK inland mails business of Consignia into the future. The Report provides no credible support for the profile of productivity proposed as achievable for the UK in the Executive Summary.