

## **New EU Postal Directive and market opening in Finland – synopsis**

This report assesses the impact of the EU Postal Directive on the Finnish postal market. It also analyses the cost structure of postal operations, which largely determines how competition within the postal market should be promoted and on what terms. Special attention is paid to how incoherent demands regarding quality standards – especially in terms of postal delivery frequency – are affecting the postal market and the operating conditions for universal service providers. Finally, the report evaluates how the quality standards should be considered when applying the EU Postal Directive.

The EU Postal Directive is transforming the Finnish postal market. Compared with the current practice, the Directive offers easier market entry terms for Itella's competitors. However, the EU Postal Directive is broad and open to interpretation. The biggest problems are created by the requirement of the current Finnish Postal Services Act that the a universal service provider must deliver regular postal items at standard prices within the entire country. This regulation together with the easing of market entry terms is leading to market entry that is not based on efficiency. When applying the EU Postal Directive and in other legislative work, the regulations should promote a form of market entry in which the new company is more efficient than the existing company. Optimally, the company entering the market should be significantly more efficient than the prevailing operator (Itella in Finland) if fixed investments are required for starting up operations. Based on this principle, a market entry in terms of universal postal services can hardly be considered desirable for society. Market entry could be encouraged for specific services, as a result of which the company entering the market would have to utilise the network of the prevailing operator. In this case the cost of leasing the network should be set at a level that would promote only the market entry of efficient companies. Standard pricing could be ensured regionally if the losses incurred by the universal service provider from providing postal services in sparsely populated areas were covered by a tax imposed on postal services in densely populated areas. Charging a fee for using the network of the universal service provider and imposing a service tax is justified if the new companies can either bypass Itella's network completely or enter the market by purchasing some of the services from Itella (or from another service provider). The EU Postal Directive also poses a challenge

regarding the obligation of universal service providers to deliver postal items on all working days. Market entry cannot be permitted for a completely different concept that would allow Itella's competitors to deliver bulk volume corporate mail twice a week, for example, while Itella is required to deliver them on all working days. The arguments for subsidising postal operations (and the possible imposition of a tax) should be based on a standard for the quality of the universal service provider and a broader quality standard that correspond to current requirements. In this regard the standard setting postal delivery speeds could even be raised. (A standard that is too low naturally invites the market entry of inefficient operators).

In the current situation the profits generated from postal operations in densely populated core areas cover the losses incurred from postal operations in sparsely populated areas. When the EU Postal Directive enters into force the situation will become more challenging, as postal operations in core areas may also become unprofitable. The report presents an estimate of how Itella's profitability will develop if the EU Postal Directive is applied in the intended way. This calculation assumes that new companies entering the market will bypass Itella's distribution network and that they will not be charged for focusing their operations on only profitable market segments. At the same time it assumes that Itella will continue its operations in sparsely populated areas on the original terms. According to the calculation, this scenario would lead to losses of EUR 150-175 million for Itella. Furthermore, Itella's overall profitability would become loss making. Competition would lower prices in densely populated areas by approximately 30 percent. Postal services would no longer be subject to standard regional pricing, as the price level in the rest of Finland would remain unchanged.