Evaluation of postal sector reforms: a synthesis

A final report prepared for

The World Bank

June 2003

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Final Report

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TSh 1,000 = US$ 1

Uy$ 30 = US$ 1

Abbreviations

Abbreviation	Institutions
ANC	Administración Nacional de Correos
GDP	Gross Domestic Product
OPP	Office of Planning and Budgeting
PSRC	Parastatal Sector Reform Commission
TCC	Tanzania Communications Commission
ToR	Terms of Reference
TPC	Tanzania Posts Corporation
UPU	Universal Postal Union
URSEC	*Unidad Reguladora de Servicios de Comunicaciones*
USO	Universal Service Obligation

Executive summary

This synthesis report follows the completion of two detailed case studies of postal sector reform in the Republic of Tanzania and Uruguay. It is submitted to the World Bank by Frontier Economics in accordance with the Terms of Reference (ToR) for the project to *Evaluate Postal Sector Reform in Tanzania* an*d Uruguay, and strategic views of the future.*

The main objective of this report is to synthesise the findings of the detailed case studies, which have been issued separately. This is intended to facilitate the development of the World Bank's strategy for postal sector reform.

The case studies that form the basis for this synthesis report resulted from research undertaken between March and May 2003. This combined desk research with visits to Tanzania and Uruguay that were undertaken in April 2003[1].

These reforms have taken place in countries that present different characteristics. They are at different stage of economic development: Uruguay is a middle-income country with per capital GDP over ten times that of Tanzania, which is one of the world's poorest countries. They have different geographical features: Uruguay is a highly urbanised unlike, Tanzania, where the vast majority of the population lives in rural areas. These factors have implications for the provision and demand for postal services.

1 An important component of the project was the collection of new data on the postal sector in both countries. The report provides new quantitative information in a number of areas that allow a much clearer picture of the path of the postal market after reform. In particular, it provides new data about: market entry, licensing and competition in the market; the price of postal services and how they compare to that of other services; evolution of volumes over the past few years; and financial performance of the incumbent public operators following the reforms. In addition Frontier reviewed a Conceptual Note on postal sector reform prepared by the World Bank.

Executive Summary

Two economic models to achieve similar objectives

Same impetus and objectives of reforms

The reforms of the postal sectors in Tanzania and Uruguay started in 1994 and 1996 respectively. The impetus for postal reform was similar and was driven by reforms in the telecommunication sectors.

These reforms were undertaken at a time when incumbent postal operators were both departments within government ministries who were also responsible for their regulation. There was limited commercial drive, poor financial performance and were unable to finance new investments that would be required to improve the quality of their service provision.

Within this context, similar objectives of the postal reforms were set out:

- create a public operator that can meet its own financing requirements;
- establish an independent regulator; and
- increase competition through a more transparent licensing framework.

The provision or maintenance of a universal service was not stated as a core or explicit objective of reform in Uruguay but was part of design of the reforms in Tanzania.

The reforms in Uruguay relied on competition to achieve these improvements in efficiency. It formally liberalised the market and allowed entry through a licensing regime. Regulation is limited and the competitive pressures are used to bring the discipline on the incumbent operator in terms of price and quality. This competition model built on the existing market conditions, whereby entry had started taking place and large utilities were bypassing the postal operator as a whole and were delivering their own invoices.

The reforms in Tanzania relied on the regulation of the incumbent operator to achieve some improvements in efficiency. The regulator regulates prices, and a Performance Contract provides incentives for improved quality of service. Liberalisation is limited in the letter market, and the regulatory framework has defined a large reserved area for the incumbent to fund the USO and to bring the operator back to profit. This regulation model built on the existing market conditions: the low demand

and low levels of existing competition in a country with a largely rural population.

Outcomes for customers

The report reviews whether these reform models have delivered the expected gains for customers. It analyses whether there has been:

- an improvement in the quality and variety of services that reflects customers valuations of quality and variety;
- a reduction in prices faced by customers leading to an increase in take up of services; and
- an increase in mail volumes.

A decade after reforms in Tanzania and half a decade after reforms in Uruguay, the result in each area is mixed.

Improved quality and choice for a selection of customers

Overall customers in Uruguay appear to have benefited from a broader improvement in the range and quality of the service provision of the Administración Nacional de Correos (ANC) in response to increase demand for postal services generally and competitive pressure. Customers in Tanzania have seen an improvement in quality of service but increase in take up has not materialised yet.

Most notably, the developments in the market since the reforms have seen the emergence of a wider range of services for customers willing and able to pay a premium for faster, more reliable service. This wider range of services cover a choice of speeds of mail delivery in both countries and reliability, for example with track and trace services introduced by the ANC in Uruguay. However, this extended range is available to customers living in urban areas and sending their mail to recipients in urban areas. It was not clear from the data whether customers who can only afford the basic postal service—especially those in rural areas—are receiving an improved service – at least in Tanzania.

Changes in access to postal services have differed between the two countries. The incumbent in Tanzania has reduced the total number of post offices in the country and relied on more franchises. This means fewer points for dropping mail and a decrease in the range of services offered at counters as many of the franchisees do not offer Tanzania Post Corporation's (TPC) newer financial services. In Uruguay, the incumbent has increased its physical presence with the adoption of a large franchise network, making the number of people served by a counter low by international standards (i.e. higher coverage level).

Overall, the development of a customer focused public operators takes time: nearly a decade after the reforms in Tanzania, the public operator has just now reached a position to develop and introduce products the reflect customer demand. In Uruguay, the incumbent set itself a programme of changes from the start of the reform and only now are some positive results emerging for customers.

No evidence of reductions in the tariffs for basic services posted by the incumbent

Tariffs for basic letter services provided by TPC remained constant in real terms until 2001, and increased thereafter. This pricing strategy appears to reflect the need improve the financial position of the incumbent and cover its costs to deliver its quality of service targets (listed in the Performance contract).

Tariffs for basic letter services provided by the ANC have substantially increased in real terms until 2001. Since then, they have declined in real terms, which partly reflect the fiercer competitive pressures as the regulator started granting licences to competitors.

Overall, the focus has been on improving the financial performance of the incumbent rather than stimulating demand or increasing take up of services through lower prices for basic letter services. However, we note that both incumbents offer discount rates to business mailers, which might have supported demand.

Competitors in both countries currently charge higher tariffs than the incumbents, in return for a perception or actual quality of service in terms of speed and reliability.

In terms of affordability, the current postal tariffs of the incumbent in Tanzania appear to be comparable to similar services (e.g. internet access), while in Uruguay they seem expensive relative to potential substitutes (e.g. telephone). The current level of tariff for basic letters in Tanzania remains fairly high and sending a single item would represent between 3 and 9% of a typical monthly expenditure for households.

Limited take up of additional letter services

Since the reforms in Tanzania, there has been no substantial increase in the level of domestic letter traffic handled by the incumbent, who remains the dominant operator for mail. The number of letter items per capita is well below one item per annum, and, at about 0.7 items per capita is also below the average for sub Saharan Africa.

The incumbent in Uruguay has seen a sharp increase in the volume of mail especially from business mailers despite the large increase in tariffs. Competitors have also benefited from the general higher demand for postal services in the 1990s. We note that at the start of the reform period, the level of items per capita seemed low given the wealth of the economy, and the faster pace of traffic growth than economic growth may reflect a catch up effect as well as an improvement in the provision of postal services.

Outcomes for postal operators

Both countries have liberalised the market but to different degrees. In Uruguay there is no restriction on entry, while in Tanzania, the incumbent enjoys a reserved area for mail items up to 500 grams.

Private sector participation

The main competitors to the public incumbents in both Tanzania and Uruguay provide an end-to-end service in urban areas and between urban areas. They carry out all activities of the supply chain.

For more remote areas, they rely on the availability of access to local delivery providers. In Uruguay, the incumbent and national postal operators rely on local bus companies for the delivery of mail in rural and to a lesser extent suburban areas. In Tanzania, the incumbent has a national network and provides access to rural areas for its competitors. For mail destined to rural areas, the competitors do not undertake any activities of the supply chain: they hand over the mail generated in the capital for rural destinations to the incumbent at the start of the process.

In Uruguay, access seeker pay an access price to the access provider (local bus companies) and in Tanzania, competitors pay the full retail price to the access provider.

The delivery of invoices by the issuing companies (i.e. utilities) is the main instance of a duplication of the delivery network in rural areas in Uruguay. This is still consistent with the cost characteristics of the sector. This self-provision benefits from the fact that Uruguay is a highly urbanised, small country (and thus provides a high density of delivery points) and that these utilities combine this service with other activities such as meter reading, and so benefit from economies of scope. While this type of operation is feasible given the geographical and demographic contexts, the average cost of delivery could be lower if one efficient operator were to deliver a higher level of traffic. This is an area that would require further investigation.

Performance of the incumbent operator and USO

A core objective of reform for both countries was to make the incumbent operator financially autonomous partly to allow universal service to be maintained and improved. Within the economic framework, developed for this study evidence of improvements in productive and dynamic efficiencies were sought.

In both countries, there is a recognition that the provision of a universal service may be at a cost to the incumbent. In Tanzania, any cost of the USO is to be covered by internal funds generated within the reserved area. In Uruguay, in a fully liberalised market where cross subsidies cannot be maintained, the cost of the USO is funded by external means. This funding formerly relied on a payment from licensed operators and a government subsidy. The government through its revenue from general taxation is now the sole provider of funds.

While the funding mechanisms for the USO cost are in place, estimates of the cost of the USO had not been undertaken. This may reflect the fact that the definition of the terms of the universal provision remains vague in both countries and has been left to the universal service providers (USPs). Consequently, the USPs have tended to develop operational definitions of the USO that confirm to available funding.

Unlike many higher income countries, where the USO definition includes the combined requirement of a uniform tariff and single standard of mail delivery across the country, both incumbents have interpreted their USOs as the provision of a uniform price with a different level of service in urban and rural areas. This approach is less onerous on the USP and may be sensible in countries with low demand for mail and a large population in rural areas. In both countries, the main element of the universal provision is the provision of access facilities on a national scale through the development of franchised counters network.

The financial position of the incumbent remains mixed a decade after the start of reform in Tanzania and five years after reform in Uruguay. TPC has recently achieved an operational profit, following a combination of sharp increases in productivity and increases in tariffs in real terms. The ANC continues to make losses and to require government transfers. Its gains in productivity have been significant but from a low base.

The competitive pressures are also leading to the increased use of postal counters for other activities, mainly the provision of financial services. The existence of the rural network of postal offices allows the incumbents to offer some financial services that banks and other competitors find hard to match (e.g. money transfer between urban and rural areas).

Regulatory issues

The independence of the regulator from a group or a single stakeholder is an important component of reform. It is necessary in order to send signals to postal operators and customers that result in higher investment and greater certainty over prices and revenues. The independence of the regulator has broadly been achieved in both countries.

However, clarity of the powers and duties of the regulator was not consistently achieved across both countries. In Tanzania, the duties of the regulator were detailed in the Act. In Uruguay, the terms were more vague.

Lastly, the effectiveness of the regulator rests on the agency gaining postal expertise. Both agencies suffer from limited sector-specific skills among their staff. The special features of the postal sector ought to be taken into consideration for formulating relevant and appropriate policies by the regulatory functions.

Recommendations for further research

These case studies have identified some common features across the two countries, which need further research to determine the extent to which the lessons from these case studies can be generalised and used to develop a broader strategy for postal sector reform.

- *USO definition, cost and funding*: different definitions of the USO for the provision of a letter delivery service in terms of products and pricing restrictions imply different burdens for the USP, and therefore call for different levels and mechanisms of funding. In the two case studies, we noted that the interpretation of the USO was less onerous as neither USPs is subject to the constraints of offering their services at both a uniform price and a same standard of service across the country. Costs and the funding of the USO have important implications for the degree of liberalisation that may be considered. As a result, it would be helpful to assess whether this flexible interpretation of the USO is common practice in developing countries, and ascertain the conditions under which this provision is most likely to meet the needs of consumers.

- *Franchised post offices:* USPs in both countries rely on franchises for enhancing access to counters facilities an decreasing the cost to the public operator. This strategy will achieve its aim of cost minimisation if the payment terms and incentives to franchises are appropriate. It would be useful to review the outcome of this strategy in more detail and draw the implication for universal access to postal services.

- *Access regimes:* the ability for new postal operators to provide services on a national scale to their customers may be enhanced through the provision of an access regime (or interconnection) to the delivery facilities of an established operator (s). Such development is being considered in Europe as the market is gradually liberalised. The current implementation of such regime in the UK highlights a number of issues with respect to access pricing, efficient entry and the maintenance of the universal service provision. In developing countries, such regimes might have developed informally as in Tanzania and Uruguay. The demand for such services, the implications for the overall efficiency of the sector, and the conditions under which they are offered would merit further explanation.

- *Scope of regulators duties:* the establishment of independent postal regulators requires careful attention to the definition of their duties and powers. These need to be set out within a broader sector policy framework at the outset of the reform programme. The two regulators examined in this study had very different duties. A larger sample, or more detailed study, should examine whether one approach is better for consumers.

1. Introduction

This synthesis report follows the completion of two detailed case studies of postal sector reform. One case study covered the Republic of Tanzania and the other Uruguay. It is submitted to the World Bank by Frontier Economics in accordance with the Terms of Reference (ToR) for the project to *Evaluate Postal Sector Reform in Tanzania* an*d Uruguay, and strategic views of the future* (see Annex 1).

The main objective of this report is to synthesise the findings of the detailed case studies, which have been issued separately. This is intended to facilitate the development of the World Bank's strategy for postal sector reform. There are two main consequences of this objective:

(1) The report seeks to extract the central messages that arose from the case studies. More detailed analysis, including figures and data, can be found in the country-specific case studies produced as part of this project.

(2) Many of the lessons emerging from these case studies are specific to the countries considered. Different countries, with different politico-economic circumstances, may not respond in the same way to the same set of reforms. Generalising the lessons from this report into a wider strategy should keep in mind differences between countries to which the strategy may be applied. Further research is required to explore the extent to which themes and practices identified in this report recur across a wider range of countries.

The case studies that form the basis for this synthesis report resulted from research undertaken between March and May 2003. This combined desk research with visits to Tanzania and Uruguay that were undertaken in April 2003. The quality and robustness of the available data varied greatly. The case studies covered a wide range of topics and the short time available has meant covering some aspects of the postal market in more detail than others. Where appropriate, the report identifies areas where further research is required.

The report is divided into three main areas:

(1) **Situation**: Sections 2 and 3 provide an overview of the situation in each country and circumstances that led to the reforms. Section 2 focuses on the relevant characteristics of the two countries and Section 3 discusses the impetus for reform,

the objectives for and path to reform and an economic framework for evaluating reforms.

(2) **Resolution**: Sections 4, 5 and 6 describe the outcomes of the reform process. Section 4 describes the impact of reforms on customers. Sections 5 reviews impact of reform on the performance of the operators in the postal market. Section 6 examines regulatory issues stemming from the mix of regulatory instruments adopted in the reform packages.

(3) **Lessons**: Section 1 summarises the key findings discussed in the previous sections and makes recommendations about further areas of work required to determine the extent to which the lessons from these studies can be generalised and used to develop a broader strategy for postal reform in developing and emerging economies.

2. Country characteristics

This section provides an overview of the framework within which reform in Tanzania and Uruguay took place.

Table 2-1 provides an overview of some of the key geographic and economic features of Tanzania and Uruguay. A few characteristics are important to note in considering their experiences of postal sector reform:

- Uruguay is a middle-income country with per capita GDP over ten times that of Tanzania, which is one of the world's poorest countries;
- Uruguay is an urban country with a very small minority of the population living in the rural areas. Tanzania is a country, and an economy, dominated by rural areas; and
- Uruguay is a small country with a small population, Tanzania is nearly ten times larger in terms of both population and surface area.

Table 2-1: Key features of Tanzania & Uruguay

	Uruguay	**Tanzania**
Population (level)	3,400,000	34,569,232
Area (sq km)	176,000	945,100
% of population in rural area	8%	68%
% of population in urban area	92%	32%
GDP per capita (US$, 2001 est.)	5,710	270

Sources: World Bank Development Indicators 2002.

These contextual factors have a substantial impact on the provision of postal services and are relevant for understanding the scope of reforms adopted by both states. These factors impact significantly on both the demand and supply sides of postal services.

❒ *Demand side*: Uruguay has a wealthier, more literate population that share many characteristics with higher income economies and postal markets (e.g. need to deliver utility bills to most households, demand for advertising mail). In contrast, Tanzania has a poorer, less literate population that have less access to utility services or income to afford many of the products that would be advertised by businesses through mail. Consequently, a higher per capita demand in Uruguay would be expected.

- *Supply side*: The countries are also very different in terms of access to the population, an important determinant of cost, infrastructure development and speed of delivery for postal operators. As noted above, Uruguay is a highly urbanised country with a well-developed highway and rail system. In contrast, in Tanzania: about 4% of roads are paved, the rail service is unreliable and coverage is limited. Therefore, more difficult challenges in maintaining a national postal network are to be expected in Tanzania.

3. Impetus for reform

This section outlines the reform programme in both countries. It begins with a discussion of our understanding of the state of the sector before the reforms, in Section 3.1. Section 3.2 then provides an overview of the objectives of the reforms and Section 3.3 discusses the approach and strategies to reform adopted in the two countries.

Overall, evidence suggests a similar impetus for reform in both countries: postal reforms were driven by reforms in the telecommunications sector. The objectives of the reforms to the postal sector itself are also similar: establishing an independent regulator, creating an operator that can meet its own financing requirements and increasing competition through a more transparent licensing framework. However, the approach to meet these objectives differed and the mix of instruments also differed across the two countries.

3.1 State of sector before reform

In both countries the provision of mail covers letters, parcels and express items. In Uruguay invoices from utilities are specifically excluded from the definition of mail, which allows the utilities to deliver their own invoices without the need of a license.[2,3]

The sector in the two countries shared a number of common characteristics prior to the reforms:

- incumbent operators were both departments within government ministries;
- incumbent operators were making losses and unable to finance new investment that would be required to improve the quality of their service provision;
- no separate regulatory office in either country, with the government assuming the role of owner, operator and regulator in both countries;

[2] We denote this practice of delivering one's own invoices in the rest of this report as "self-provision".

[3] In order to ensure comparability across countries, when discussing mail items, throughout this report, self-provision in Uruguay is included within total items delivered, unless noted otherwise.

- only limited entry into the postal market by other operators, with entry mainly in the provision of international express services; and

- lack of commercial drive and focus on the part of the public postal operator.

The main difference between the two countries' institutional structure at the time was that in Tanzania a single ministry was responsible for the provision of both postal and telecommunications services, whereas in Uruguay telecommunications services had existed as a separate institution since 1933.

3.2 Objectives of reform

The drive for reform in both countries arose from a desire to reform the telecommunications sector in response to international changes in telephony. These reforms had important implications for the development of the postal sector:

- in Tanzania, they resulted in the separation of post and telecoms into two different corporations, and the creation of a separate regulatory office; and

- in Uruguay, it resulted in the creation of an independent telecoms regulator that was also to be given responsibility over the postal sector.

In line with these decisions, the status of both incumbents was changed. Tanzania Posts became a corporation (Tanzania Posts Corporation, TPC), and in Uruguay El Correo became a more autonomous entity, the Administración Nacional de Correos (ANC).

In neither country was there a single, unambiguous statement of the objectives for postal reform (i.e. a sector policy statement). The objectives common to both countries were the establishment of an independent regulator and the creation of a financially self-sustainable postal operator. Below we examine briefly some of the more country-specific objectives.

3.2.1 Tanzania

There was a more concrete statement of reform objectives in Tanzania than in Uruguay, possibly reflecting the involvement of the World Bank at an early stage of the reform process. The World Bank's *Staff Appraisal*

Report and *Implementation Completion Report* identify the main objectives as:[4]

(1) Establish a market oriented policy and regulatory framework, to introduce private sector participation … and develop an action plan to secure private investment in basic services;

(2) Facilitate commercialisation and corporatisation of Tanzania Post and Telecommunications Company and build its institutional capacity; and

(3) Eliminate existing bottlenecks in the availability of telecommunications services.

Some of these objectives (e.g. the third) are directly focused at telecommunications, which underwent reforms at the same time, while others apply equally to postal services. Interviewees translated these government objectives for posts, as:

- creation of operationally and financially independent public postal operator;
- meeting basic requirements of households, including increased investment to improve quality of service and coverage;
- development of autonomous regulatory framework; and
- increased accountability for the public operator through a performance contract.

3.2.2 Uruguay

Formally stated objectives of postal reforms in Uruguay are more difficult to identify but interviews indicate they included:

- creation of an independent postal operator;
- creation of a separate independent regulatory authority; and
- increasing competition in the provision of postal services.

This is in line with a *Bill on the Regulation of the Postal Activity*, which stipulated clear objectives for the sector and was presented to Parliament in 1998 but did not obtain approval. This Bill included the above

4 *Implementation Completion Report*, IDA 24860, World Bank, June 2001

objectives for the sector with a qualification on competition whereby the licensing regime was to control the extent of entry in the sector. It also gave the responsibility to the government to monitor the adequate provision of the universal service. Our understanding is that there has been no subsequent replacement legislation or decrees to clarify the implementation of licensing entry and universal service.

In both countries there was recognition that new investment was required in order to improve quality of service, and that limited government resources were available to finance such investment. Therefore, many of the above objectives (e.g. creation of independent operators and regulators) were aimed at generating the required investment and quality of service improvements. In Tanzania the focus was on the creation of a strong incumbent that would be able to invest and improve access and quality of service. In Uruguay the emphasis was on the increase in competition from private operators who would invest to capture market share and so improve consumer choice and quality through competition.[5]

3.3 Approach to reform process

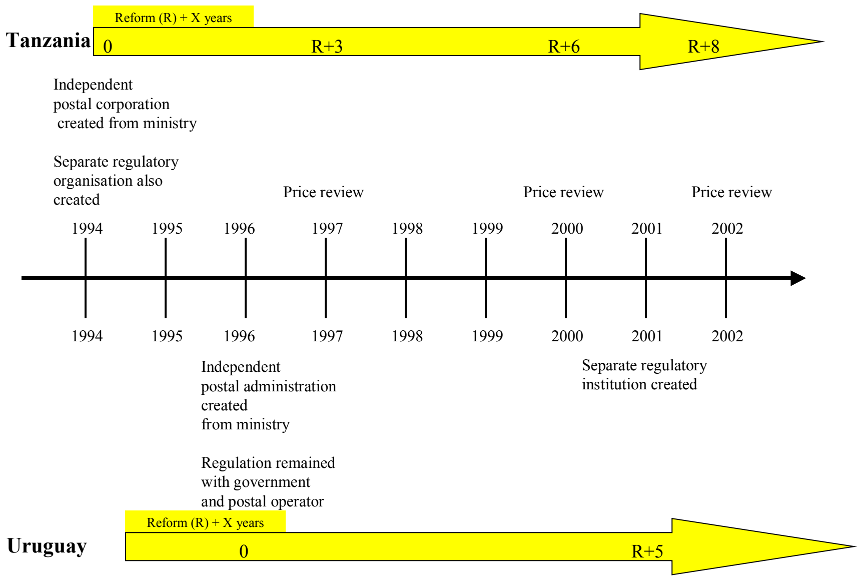
There are important differences the detailed approach to reform in the two countries. Overall, the reform package in Tanzania appears more comprehensive than that in Uruguay.

3.3.1 Setting up a separate regulator

The timing of the main reforms in the two countries is illustrated in Figure 3-1. Tanzania separated regulatory and operational functions simultaneously at the beginning of the reforms while Uruguay created a separate entity that acted as regulator and operator for five years, after which a separate regulatory entity was created.

[5] The Uruguayan government is looking to extend the de-monopolisation and support private sector participation in all utilities, including postal service (*source*: World Bank project "*Uruguay Public Services modernization—Technical Assistance*", 2001).

Figure 3-1: Reform process



3.3.2 Setting targets for a financially viable operator

In addition to the creation of a separate regulatory office, the objective common to both Uruguay and Tanzania was a desire to create a financially independent operator. However, the two countries adopted distinct approaches in their attempt to reach this stage.

In Tanzania a reserved area was created that was intended to help finance the operator, and its universal service obligations (USOs). At the same time a Performance Contract was put in place that set explicit financial and quality of service targets for TPC. The Performance Contract is summarised in the box below.

In Uruguay, the absence of a reserved area and the existence a large degree of self-supply by utilities led the government to decide on the provision of decreasing annual subsidies from the date of reform, 1996, until 2000 when they were supposed to end. This arrangement was intended to provide the operator with a transition period over which it could develop new products to ensure a revenue stream that would allow it to be financially independent. In fact, the subsidy has been continued beyond 2000 with substantial payments still being made at the time of this report in 2003 and the link between improvements in efficiency and subsidy levels appears to be less clear.[6]

Performance contract of Tanzania Posts Corporation
TPC's quality of service is governed by a Performance Contract that it signed with the PSRC and the (Tanzania Communications Commissions (TCC). The performance contract provides for both a bonus, in the case of out-performance, and penalties, in the case of underperformance. TPC's performance is judged against five categories: (1) Speed: an agreed percentage of inter and intra town letters must be delivered within a given number of days outlined in the contract. (2) Security: theft of mail must be kept below a specified level; (3) Profitability: TPC must attain a defined pre-tax rate of profitability (4) Business growth: mail volume must grow year on year by defined percentages (5) Customer satisfaction: customer complaints, to both TPC and TCC, as a proportion of mail volume must be below pre-defined percentages. The categories are weighted differently, with profitability given the highest weighting, in order to create an index. The penalties for failing to be awarded a passing grade range from a loss of 3% of salary for management and annual fees of Board members to the dismissal of the Board, Post Master General and their assistants.

3.3.3 Defining the reserved area and the components of mail

As noted briefly above, in Tanzania the reform package went beyond the measures of setting up an independent regulator and setting targets for a financially viable operator. The reform package also included an explicit definition of a reserved area for the universal service provider to meet the overall goal of having a financially viable universal service provider. The reserved area was defined as all mail items weighing up to and including 500 grams.

In contrast, in Uruguay, the reform programme did not include the creation of a reserve area. In addition, as noted above (see Section 3.1), self-provision was excluded from the definition of mail and the reforms did not attempt to revise this definition, which might have supported the

[6] This is an area that would merit further investigation.

goal of creating a financially independent universal service provider. The reform introduced a licensing regime for operators providing mail services whereby licensees had to pay a postal tax to the universal service provider. This licence requirement was not extended to utilities and other businesses that delivered their own invoices and the definition of "mail" continued to exclude invoices.[7]

3.4 Economic framework for evaluating reforms

Both countries adopted different models to reform the postal sector. Uruguay adopted a competition model and Tanzania, a regulatory model. These two models aimed to bring about improvement in efficiency.

3.4.1 Improvements in efficiency

Economists distinguish between three types of efficiency - allocative, productive, and dynamic efficiency. Competition will not necessarily improve all forms of efficiency in all circumstances. Regulation can also achieve some of these gains for the sector. In broad terms -

- *Allocative efficiency*: involves resources being allocated optimally throughout the economy. At it simplest, it involves achieving the right level of prices, the right quality of service and the right allocation of production among firms. While competition can bring some reduction in prices, regulation can also control the level of prices. Regulation is less well suited than competition to achieve the right quality of service but can avoid the loss in allocative efficiency that results from the duplication of fixed costs associated with competition.

- *Productive efficiency*: involves the efficient production of a given output, assuming that total production has been allocated efficiently across firms. Competition is likely to sharpen incentives of firms to be productively efficient. In principle, productive efficiency can also be enhanced through specific forms of price regulation.

- *Dynamic efficiency*: involves the right level of investment in innovation and new ways of providing services, or in better or new products and services. Competition may be better suited to provide the incentive for innovation than a relatively uncontested position of market power accompanied by regulation.

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7 This issue is now less important because the postal tax on licensed operators was abolished in 2000.

The brief discussion above indicates that more competition will tend to be beneficial for efficiency as long as it does not involve too large a duplication of fixed costs.

In this report (and the individual case study report), we seek evidence on the extent to which both models have brought about improvements in efficiency.

3.4.2 Competition and universal service

Modern market economies are built on the assumption that competition is beneficial and increases the welfare of society. Competitive markets are felt to provide lower prices, more choice, better quality and more innovation than monopolistic or oligopolistic markets.

However there is a conflict between increasing competition and achieving a Universal Service Obligation (USO). The nature of a USO is that, given uniform and affordable prices, some elements of the service will be profit making and others loss-making, with the former cross-subsidising the latter. If competition occurs for the more profitable elements of the USP's services, and drives down prices and profits, then this may restrict its ability to provide the loss-making elements of its service, and so threaten its ability to meet its USO. As such, when introducing competition, there is a need to ensure that the USP total revenues can still cover its overall costs, including the costs of the USO – if no other funding mechanisms (e.g. external funding through general or industry taxation) are considered.

In Tanzania, the incumbent has been granted a large reserved area; concern for the USO is likely to have influenced the choice of reform model through regulation. In Uruguay, where the funding of the cost of the USO is provided by government subsidy, improvement in efficiency were to be brought about through a competition model.

3.5 Key findings

The main findings that arise from this section are that the two countries had:

- *the same impetus for reform*: the need to reform the telecommunications sector created the initial impetus for postal sector reform in both countries;
- *similar core objectives of reform with a different focus:* the creation of an independent regulatory authority and financially independent

operator and the maintenance of an acceptable level of universal postal services;

- *different approaches to the implementation of reform:* legal and regulatory reforms proceeded at a different pace in the two countries, largely as a consequence of the implementation of the entire reform package at one time in Tanzania compared to the more gradual approach in Uruguay;

- *different set of regulatory tools used to pursue the objectives:* very different approaches were taken to move the incumbent operator toward financial independence, with a focus on decreasing subsidies in Uruguay and a reserved area and a Performance Contract in Tanzania; and

- *different overall approach to achieve improvement in efficiency:* a market driven approach wherein increased competition would lead to a more efficiency public postal operator (in Uruguay) versus a regulatory reform driven process wherein the definition of the various components of the postal market (universal service, reserved area, regulatory responsibilities) would lead to a more efficient public postal service.

Overall the reform package in Tanzania appears more comprehensive, bringing together several regulatory and institutional measures to support the development of a financially independent operator. In contrast, Uruguay has relied more on new private sector entry and competition to bring about similar outcomes. The table below summarises the similarities and differences between the two reform processes.

Summary: Similarities and differences between Tanzania and Uruguay	
Similarities	**Differences**
Starting point: government owned postal operator sitting within a ministry *Impetus for reform*: need to modernise telecommunications services *Overall objectives*: creation of independent operator and regulator, private sector participation (PSP) and new investment	*Path to reform*: Tanzania started first and created independent regulator and operator simultaneously; Uruguay created independent operator 5 years before the regulator *Focus of reform*: Uruguay focused on creating a competitive market through licensing lots of new entry; Tanzania focus on rehabilitating incumbent through regulation *Regulatory tools:* emphasis in Uruguay on competition to control prices and quality, in Tanzania emphasis on regulatory regime and Performance Contract.

4. Outcomes for customers

Ultimately the reforms were about improving customer services. In this section, we review the gains for customers in terms of access to postal services and product choice and then discuss the gains in terms of quality of service and tariffs.

4.1 Access and choice

Changes in the access to postal services following reforms have varied depending on the customer group considered. Some customers have access to a wider choice of services (e.g. speeds of delivery for their mail) provided by alternative providers and through a wider range of products offered by the incumbent. Other customers, particularly those in rural areas, have witnessed the closure of some post offices and less frequent delivery times.

4.1.1 Tanzania

The general picture emerging from Tanzania is one where access has improved for mail within and between major urban centres and international destinations but has worsened, or at best remained unchanged, in rural areas. Entry of new private operators has provided households and small firms in urban centres with more choice of provider and a wider range of potential services.

At the same time, the need for TPC to maintain financial stability in the absence of any government support, has led to a decrease in the total number of post offices (corresponding to the decrease in those operated by TPC). In 1993 there were approximately 500 post offices and this had decreased to 387 by 2003. Since all regular mail delivery and despatch is made from post offices this has had a substantial impact on access. Although precise figures were not available, about 75% of the reduction in post offices has occurred in rural areas. On top of this, many rural post offices previously operated by TPC were franchised or sold outright and so are no longer operated by TPC staff. This has resulted in a decrease in the range of services offered.[8]

[8] For example, many of the newer financial services offered by TPC are available only in post offices that are owned and operated by TPC staff.

Despite these changes, several other developments since reform have improved access for some groups of consumers:

- new entry by international and domestic courier and bus companies has provided customers with more choice and a larger range of access points; and

- the development of new services by TPC, partly in response to this new competition, including overnight delivery of regular mail between urban centres and the decentralisation of some of the private post boxes, has improved access. The range of financial products has also increased.[9]

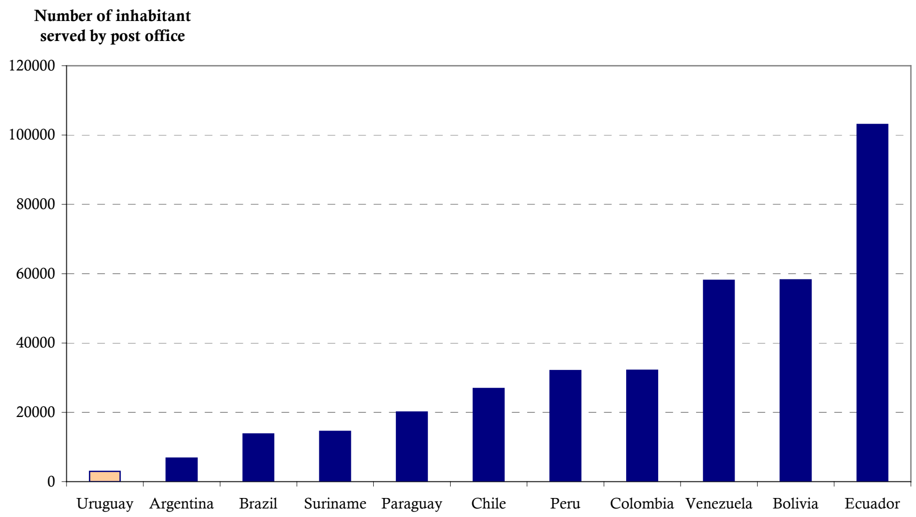
Households and businesses continue to receive mail at their mailbox located at the counters office. Only the express services offer some limited delivery to business addresses in the main urban centres.

4.1.2 Uruguay

In Uruguay the picture is different, partly because it is very urbanised. The ANC began the development of its franchise network in 1998 and by March 2003 there were a total of 1,021 postal agencies in the country. This provides the ANC with complete coverage of localities with more than 400 inhabitants. Most of these agencies are not operated by the ANC, which has only 155 corporate counters, of which 31 are located in Montevideo. The development of this network means that by 2003 there were about 3,000 inhabitants per permanent office, which is a high coverage when compared with neighbouring countries as shown in Figure 4-1.

9 TPC is a cash handling agent, not a bank, but has exploited this role profitably.

Figure 4-1: Inhabitants per permanent post office in selected countries



Source: UPU data and ANC data for Uruguay

Considerable entry of competitors over the past few years means that access to postal services remains very high in the country. In addition, the response by ANC to the competition has improved access. The ANC offers delivery to the door for all customers other than those in small villages.

The ANC has also expanded its product ranges since the reform. The prime change is the introduction of track and trace option to its domestic mail services. New financial and logistic services have also been introduced (e.g. *CorreoBanc* and *Sur postal*, see main case study for details). This range has expanded rapidly as new features were added to their products and a rationalisation is now being considered. It has re-organised itself and set up a business unit for business mailers.

4.1.3 Alternative means of access?

Of particular interest is that neither country has put in place street collection boxes. Instead both countries continue to rely on their post offices and counters operations to collect mail. The reasons for their absence are not clear but would be worth more detailed investigation.[10]

[10] In interviews, neither public operator expressed strong reasons why collection boxes would fail. However, there are concerns about security of mail left in such boxes and whether those sending mail would use them because of a lack of trust in both their security and in the operator to collect the mail from boxes at frequent intervals.

4.2 Quality of service

The most difficult indicator of performance to evaluate is the degree to which quality of service has improved since the reforms. This is largely because of the lack of measurement of relevant indicators prior to the reforms, and their limited measurement since the reforms.

It is clear that many of the new entrants are providing a higher quality service at a higher price. The extent to which the quality of the basic mail service offered by the incumbents has improved is difficult to determine.

In Tanzania, TPC has been subject to a Performance Contract since 1997. This Performance Contract includes targets in speed of delivery.

To-date TPC has met the overall requirements of the Performance Contract. This means that a weighted average index of its performance in each of the five areas has been satisfactory. In practice, this has meant that TPC has improved the speed and security of its service, has had limited customer complaints but has done poorly on both profitability and volume growth. The improvement in speed has arisen mainly from the purchase of new vans and trucks to provide overnight delivery between urban centres.[11] Security has improved as a result of improved monitoring of employees and stricter enforcement of penalties for those found contravening security rules.

There is no similar explicit framework for quality of service targets in Uruguay. The ANC sets its own targets subject to competition from other operators. Consequently, in 1998 the ANC produced a Quality Manual, which sets out its vision "*to be a highly-competitive company, leader in the postal sector, promoting the technological revolution of information systems with the highest commitment level, professionalism and motivation of its human resources in a customer-focussed organization*." The content of the Manual is described in more detail in the main Uruguay case study. However, Table 4-1 provides an overview of one of the measurements of quality that has been monitored since 1998 and the delivery time achieved by the ANC[12].

[11] This was funded under the World Bank loan issued at the outset of reforms.

[12] Such measurements are in place for products that have a track and trace option only.

Table 4-1: Quality of service: target and actual for Uruguay
Week commencing 3 March 2003

	Target	Actual
Registered Letter (D+2)	90%	89.7%
Priority Parcels Postal (D+1)	90%	65.5%
Parcels PP (D+2)	90%	82.3%

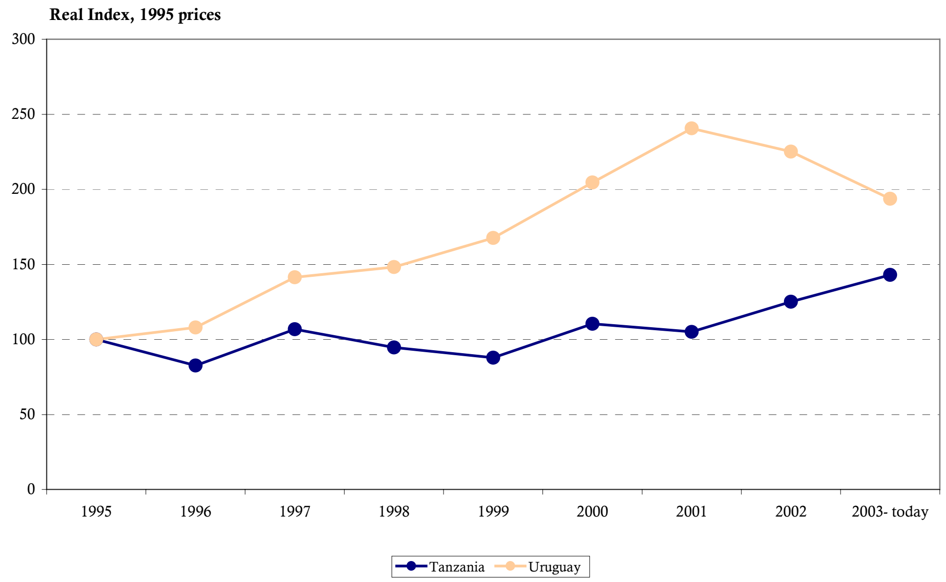
In the week monitored as part of this study, the target for registered letters was met but there was under-performance in both parcel services. However, this represents a considerable improvement since 1995, when compliance with delivery standards was inferior to 30% and delivery time could take up to 5 days.[13] Further evidence for this general improvement in quality can be found in the award to the ANC of a National Quality Award in 2000, something that was unheard of prior to the reforms.

4.3 Tariffs

Tariffs in both Tanzania and Uruguay have increased substantially in real terms over the period of reform as shown in Figure 4-3. The tariffs in Uruguay increased at faster pace than inflation until 2001, when the regulator started granting licences to new postal applicants. The resulting competition has prevented the ANC from raising tariffs since 2001.

[13] Source: El Correo, Discussion Paper by the University of Montevideo, 2000

Figure 4-2: Evolution of real tariffs for incumbent's basic letter service since reforms



Note: these tariffs refer to the first weight band of a basic letter item in both countries.
Source: ANC and TPC, 2003

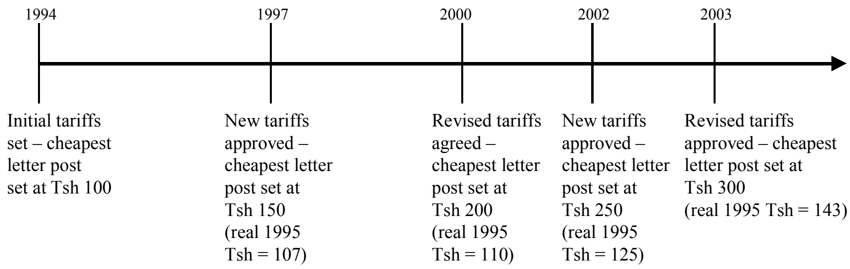
Relative to both per capita income and the prices charged for competing services (e.g. internet and even bus fares required for direct personal delivery) prices appear to be high. Given the importance of tariffs we discuss them in more detail, individually for the two countries in the rest of this section.

4.3.1 Tanzania

Figure 4-3 illustrates tariff reviews that have taken place since 1993 and the impact on the cost of sending a letter that fits within the lowest weight category.[14] This illustrates that tariffs for basic services have increased steadily in real terms since reforms were introduced, with substantial real increases since 2000.

[14] Until the 2000 price review the maximum weight for a letter at the price indicated in Figure 4-3 was 10 grams, thereafter it was increased to 20 grams.

Figure 4-3: Tariff adjustments since reform



The degree to which these tariff changes and the resulting levels in 2003 affect consumers depends, in part, on their affordability. There are many potential measures of affordability. Here we examine two, the cost of postal services compared to: income levels and other basic goods.

There is no comprehensive analysis of income levels in Tanzania. However, the *2002 Household Budget Survey* provides estimates of household expenditure. This indicates an average consumption expenditure, per capita per month, of about Tsh10,000 in 2001 (approx. US$10). Current tariff levels for basic letter services range from Tsh 300 to 900. These would imply that letters cost between 3% and 9% of typical monthly expenditure. However, income levels in Tanzania are very different between rural and urban regions. In the urban regions that create most of the demand for postal services, the equivalent household expenditure is about Tsh 22,000 and so letters would cost between 1% and 4% of per capita consumption. In contrast, rural consumption expenditure stands at around Tsh8,500, making letters relatively more expensive, between 4% and 11% of expenditure.

An alternative measurement of affordability is to compare the cost of a letter to that of other commodities. This comparison indicates that current postal costs do correspond roughly to the price of some basic commodities and other forms of communication. For example:

- a loaf of bread costs between Tsh 200 and 300;
- half a litre of milk costs about Tsh 400;

- water supply from the network costs about Tsh 400/cubic metre;[15] and

- the cost of 30 minutes of internet access ranges from Tsh 300 to 500.

Discounts from the published tariffs are offered to large customers. There are no rules about the level of discount which varies from about 10% to in excess of 25%.

4.3.2 Uruguay

The process of tariff adjustment is different in Uruguay because it is under the control of the ANC and considerably more influenced by competition in the market. The ANC has modified its tariffs frequently for the basic letter service. However, the degree of competition since the creation of an independent regulator in 2001 and the worsening of the state of the economy have meant there has been no change in the ANC tariffs since 2001.

A basic ANC letter is charged at Uy$ 12 (US$0.41) and for each of the two levels of track and trace a letter below 200 grams is charged at Uy$15 and Uy$18, respectively. Evidence from interviews indicates that the charges for basic letter service are at least 15% lower than tariffs for mail of similar weights offered by competitors. Consequently, large customers who are satisfied with the quality of service provided by ANC have tended to remain customers while those who have experienced difficulties with the reliability of the ANC have chosen to self-provide or contract another licensed operator.

Despite the fact that the ANC's tariffs are lower than its competitors the tariff does appear high relative to the cost of other commodities. For example, a local telephone call costs about Uy$0.23 per minute, which would allow a 50 minute conversation for less than the cost of a letter posted in the regular mail. Similarly, a single bus fare costs about Uy$13 which means that, within urban areas, an individual could likely take a bus ride and visit their counterpart for about the same price as a regular letter[16].

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15 Most of the population receives water supply from wells and trucks, the latter may cost up to ten times the price of network delivered water.

16 This is consistent with the possibility that ANC is not operating at minimum efficient scale, as a result of diversion of volumes through self-provision.

Discounts to large customers from the published rates vary considerably, generally anywhere between 10% and 33%. This allows ANC to maintain prices below those of its competitors, who also offer volume discounts.[17] However, self-provision continues to be favoured by several large companies with established networks, and the electricity provider, UTE, reported having no intention to hand over this type of mail to postal operators in the future. The UTE argues that the quality-adjusted marginal cost of its established networks continues to be below that of ANC, despite the discounts ANC is able to offer.

4.4 Key findings

The main findings that arise from this section are

- *Mixed improvement in access*: the outcome of the reforms for customers depends crucially on their location. For customers in urban areas the reforms in both countries have increased their choice of service and of service provider. For customers in rural areas the reforms have failed to improve service provision and, at least in Tanzania, have resulted in a decrease in access because of post office closures.

- *Improved quality of service and choice*: the quality of service provided by the incumbents has increased, although for customers the main increase in quality of service probably stems from their ability to use alternative, higher quality, operators. There is more evidence of improvements in the incumbent's provision in terms of quality and choice in Uruguay than in Tanzania.

- *Tariffs have not declined yet*: competition in Uruguay has limited price increases, although continued government subsidies have also facilitated this process. In Tanzania prices have risen steadily since reform and a stamp would now form a significant proportion of expenditure, especially for rural families.

The table below summarises the similarities and differences between the two countries.

[17] Two public institutions can directly negotiate prices without the need to tender the services. In this case, the agreement is signed by the two Boards of these entities. This is an advantage enjoyed by Correo and not its competitors in that market segment.

Summary: Similarities and differences between Tanzania and Uruguay	
Similarities	**Differences**
Increased range of services and operators: wider choice for customers, especially those in urban areas *Rise in tariffs*: steady increase witnessed in Tanzania, and pre-2001 increases in Uruguay that stopped following an increase in competition *Improvement in speed and security of mail delivery*: in both countries new entry and improved performance by the public operator has improved speed and security of mail delivery	*Comparability of postal tariffs to other services*: in Tanzania current tariffs appear to be comparable to those of similar services (e.g. internet access), while in Uruguay they seem expensive relative to potential substitutes (e.g. telephone) *Access*: Uruguay has managed to maintain a high level of access to post offices, unlike Tanzania

5. Performance of postal operators

This section reviews the performance of the incumbent and other postal operators following reforms. We begin with a review of the cost characteristics of the postal sector to ascertain the scope for entry. We then discuss the nature of private sector participation in both countries and finally review the performance of the incumbent since reforms.

In common with the objective of this report, this section discusses particular elements of performance in general terms and seeks to extract the central messages and preliminary results. More detailed analysis, including figures and data, can be found in the country-specific case studies produced as part of this project.

Overall, extensive private sector participation in the provision of postal services has developed in the two countries considered, particularly in Uruguay. Entry has taken place and these operators provide end-to-end services in urban areas and/or act as intermediaries to both the incumbent and other large operators for the final delivery of mail. The access regimes in place in both countries are market outcomes rather than regulatory requirements.

The performance of the incumbent operators since the reforms has been mixed. The data provided by the incumbents for this study suggests an increase in demand for mail services from the ANC and a broadly flat level of traffic in Tanzania. This may reflect partly external factors such as economic growth and partly internal factors such as substantial tariffs increase in real terms for basic letter services. Productivity gains have been good but remain fairly low when compared with countries with similar economic (e.g. GDP) characteristics. Productivity gains and increase in revenue per item have moved Tanzania from a loss at the time of the reform to an operating profit recently, a rarity for postal administrations in the region. In Uruguay, the ANC continues to make a loss and requires significant government transfers.

5.1 Cost characteristics of postal services and scope for entry

The provision of postal services involves a number of complementary activities. These typically include:

- collection – typically at pillar boxes and counter offices;

- outward sorting –segregating mail for various major destinations by hand or by machine;
- transport –long distance transportation between major destination points;
- inward sorting –sorting mail from all over the country into smaller streams to be directed to local delivery offices; and
- delivery –the final preparation and the actual delivery of mail to addresses or mail boxes.

The cost characteristics of each activity is a determinant as to whether entry is feasible for a sufficiently large number of operators to create a sustainable competitive environment. In particular, entry depends on the extent of scale effects – which can place a limit on the number of operators – and whether the incumbent's costs are sunk to the extent that they represent a credible barrier to entry to new entrants.

We draw upon existing research in the area, and our own understanding of the cost characteristics of the postal sector[18] to create a basic model from which to view reforms in the two countries:

- *Collection*: there is general acceptance that there are increasing returns to scale in collection from pillar boxes (at least daily), suggesting that activity may be expected to be handled by one operator, and it would be inefficient to duplicate collection points. However, collection at businesses' premises by an entrant may not exhibit increasing returns to scale, since this activity requires labour and a fleet of van to undertake that task. Geographical cost differences in collection arise as a result of different distances between collection points and collection densities which vary across the country.

- *Sorting and trunking*: it is commonly understood that the minimum efficient scale for sorting and trunking activities is relatively low, hence these activities can be replicated by a number of players at smaller scale without increasing the average cost.

- *Delivery*: Evidence from various countries suggests the presence of economies of scale for the delivery of mail to a final address. However, in varying the frequency of delivery, entrants may reach a viable scale of operation with relatively low volumes. While it may be

[18] Extensive research on postal economics can be found in books edited by Michael Crew and Paul Kleindorfer.

difficult to duplicate a next day delivery across the whole country, the ability for entrants to provide delivery may be enhanced if they can exploit economies of scale by reducing the frequency of delivery or serving only selected routes. Delivery costs differ according to geography or distance between delivery points and the volume of mail. Different distances between delivery points, reflecting different population density, will imply different mode of transport costs and also staff requirements. This is why postal operators have argued that it is more expensive to deliver to rural households than urban ones. Therefore, the existence of economies of scale in any particular delivery service may not be enough to establish that the total delivery market is a natural monopoly.

Overall, this suggests that entry could take place in a liberalised market and that even if any individual delivery service may be a natural monopoly (e.g. national daily delivery), it is possible that the market could sustain a number of slightly different delivery services that could compete with each other.

The observed entry in Uruguay and Tanzania is consistent with the expected entry according to the cost characteristics of that industry.

5.2 Outcome for private sector participation

In both Uruguay and Tanzania there has been extensive private sector entry into the postal market since the reforms have taken place for the provision of end-to-end services or the provision of intermediate services to the incumbent.

5.2.1 Entry and their targeted customer groups

The nature of entry in both countries is in line with the expected nature of entry according to the cost characteristics of the functions of the sector. There is no restriction on entry in the postal market in Uruguay, the market is liberalised. In Tanzania, there are restrictions on entry in the letters market: TPC has been granted a reserved area over the delivery of letter mail weighing up to 500 grams/ Tsh 1000 (US$1).

Private sector participation in Tanzania has been characterised by the entry of international courier companies, serving mainly the international express mail market. As for the domestic market, bus operators offer letters and parcels services between bus terminals in major urban centres. This source of competition is dominated by a single bus operator, Scandinavia Express, which handles over 10% of the letter market. The (volume) market share of TPC is at 84%. The main users of competitors are households and small and medium businesses.

In Uruguay, it has been characterised by the issuance of 36 new licenses between the creation of the independent regulator in 2001 and early 2003. This brings the total number of licensed competitors to the ANC to 125. Local bus operators provide both end-to-end services to their customers in the local area and deliver the mail of the ANC and other operators in rural areas. The source of competition for end-to-end letter service is dominated by a handful of national postal operators, which serve mainly urban areas and target business customers. In addition to these other operators, self-provision plays a large role in the letters market: utilities deliver their own invoices which amount to about 50% of the total letter mail (items of correspondence plus invoices). This leaves the ANC with a market share of 33% or so (based on a total including invoices) or 60% (based on a total excluding invoices).

New entrants in both markets are clearly targeting the most profitable customer groups. In Tanzania, new entry has focused on the international express mail market and the inter-urban letters and parcel markets. In Uruguay entrants have also focused on the more profitable urban markets. The high level of urbanisation in Uruguay means that in practice new entrants cover most of the inhabitants, unlike Tanzania where TPC is the sole provider to the majority of the population living in rural areas.

In both countries, rival operators compete on speed of delivery and reliability for domestic letters, they do not necessarily deliver to the final address (e.g. bus terminal). These services are provided at higher tariffs than the incumbent's.

5.2.2 Network efficiencies

In Uruguay, entry on a national scale in the sector has been possible thanks to the possibility of access/interconnection arrangements for rural delivery with local bus operators. Both the ANC and rival national operators use this mechanism to complete their end-to-end letter service provision in rural, and to a lesser extent, suburban areas.

On the other hand, the distribution of invoices by issuing companies (self-delivery) across the country does not make use of other operators. They have duplicated the delivery function in rural areas as well as in urban areas but benefit from some economies of scope by combining invoice delivery with other services (e.g. meter reading). It is important to note, that this delivery function is infrequent, and thus is not a parallel replication of the USP network for a *daily* service provision.

In contrast, in Tanzania the services offered by the different operators are relatively complementary. While some inter-urban operators compete with TPC, TPC's focus in on the intra-urban and rural markets. It has a negligible proportion of the international market and operates some vehicles between major urban centres. When the competing operators, both in the international and inter-urban markets, receive letters for rural regions they tend to pay TPC to make those deliveries.

This is consistent with the view that the delivery function presents some natural monopolistic cost characteristics (i.e. there are economies of scale and duplication of that function cannot be easily made in sparsely populated areas).

5.2.3 Access regime

In both countries, operators have entered into alliances with each other to provide a comprehensive postal service with high levels of access (interconnection).

Tanzania

In Tanzania, the low density, rural population provides the incumbent public operator with some advantages. In particular, its established network of post offices means it can serve customers anywhere in the country and, perhaps more importantly, promise to deliver mail posted in urban areas to any destination within the country. No entrant has been able to replicate this network. This has led to two forms of access arrangements:

- *Domestic arrangements*: while data was not available, interviews indicated that TPC was regularly used by its competitors when they are handed mail to be delivered to an address outside of the main urban areas. No formal arrangements have been made between TPC and its competitors. Instead, upon receiving mail for destinations outside their service areas, competitors simply take that mail to a TPC office, buy the required stamps at full rate and post the item.

- *International arrangements*: TPC has just entered into a formal contractual arrangement with DHL that seeks to exploit their mutual strengths. Under the agreement DHL will use TPC to deliver international packages that its Tanzanian depot receives which are addressed to destinations outside of Dar es Salaam. TPC, in turn, will use DHL for items that it receives for shipment abroad. A six month trial period of this arrangement has been agreed and is expected to begin in July 2003. If the trial is successful a formal access regime will be agreed between the two providers.

The interconnection that exists between TPC and its domestic competitors does little to enhance the efficiency of the postal service to the benefit of customers. Many competitors either exploit poor information on the part of customers (i.e. customer that believe they will receive a better service but whose items are simply then delivered to TPC) or offer a slightly easier access point to customers (i.e. transport items from a convenient drop-off point for the customer to a TPC post office). By contrast, the international arrangement may offer genuine benefits as both domestic and international customers have access to a wider range of services. An important point to note is that both of these access regimes have developed in the absence of any regulatory efforts.

Uruguay

In Uruguay the incumbent does not have a national network, which it makes available to other operators. Instead, the ANC relies on local bus operators and to a lesser extent on some of its franchises for the delivery of its mail. The ANC indicated that it is able to connect 111 major cities. It reaches another 48 destinations (smaller cities) via local bus operators that provide both local transportation and delivery, and also relies on some of its franchises to deliver the mail to final addresses.

Similarly to the ANC, national postal operators also use local bus operators for the final delivery in rural areas.

This market behaviour reflects the cost characteristics of the delivery function and the effort to minimise costs overall given the level of mail volumes to be delivered. In urban areas, postal providers can provide a full end-to-end service. In rural areas, they rely on the access service provided by the local bus operators. The regulator does not intervene to set the terms and conditions for this access provision. We understand that the ANC pays its franchises for their delivery of the ANC mail on a per item basis. The amount paid is a decreasing function of volumes to be delivered by the sub-contractor.

Lessons from access regime in developed countries

Access regimes in posts whereby incumbent provides competitors with access to their network facilities are new[19]. This reflects the limited liberalisation that has taken place so far in post and the limited regulatory

[19] Incumbents provide access to their own customers. Large businesses typically undertake some activities themselves such as sorting and hand over their mail to the incumbent nearer the final delivery points. Products that include this workshare components are found in the USA, and most European countries.

tools that allow the regulator to impose that the incumbent provides access to competitors.

Experience in higher income countries has raised a number of issues also relevant for access regimes in developing countries, some of which are the subject of current research[20]:

- *Approaches to access price determination*: there are two main approaches for deriving access prices. A top-down approach consists of excluding the costs of the activities by-passed by competitor from the retail price charged by the incumbent. A bottom-up approach consists of deriving an access price based on the costs incurred by the incumbent in undertaking the activities such as delivery on behalf of entrant.

- *Contribution to fixed cost*: it is argued that the postal network comprises a high level of fixed costs, some of which arise out of the provision of a universal service. This fixed costs ought to be recovered by the universal service provider through the pricing of either its retail products or its access products or a mix of both. The extent of fixed cost recovery through access prices has an impact on entry in the sector.

- *Access regimes in broader contexts*: access regimes cannot be assessed in isolation and ought to take into consideration the regulation of the prices of the incumbent.

5.3 Outcome for the incumbent

We now turn to the performance of the incumbents since the reform. As indicated in both countries, the financial position of the incumbent operators was negative and a key objective of reforms was to make these operators financially autonomous. We also pay particular attention to the incumbent because in both countries, they are the universal service providers.

5.3.1 Volume growth

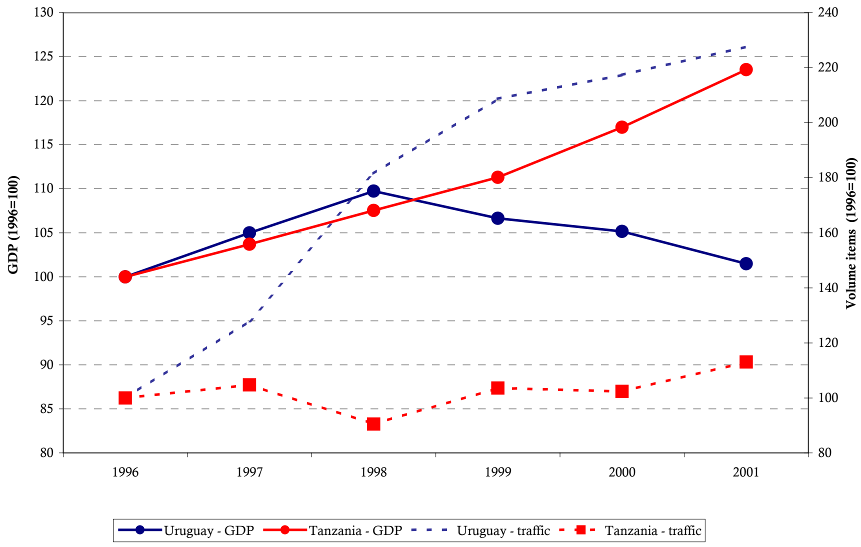
Domestic volume handled by the incumbent grew considerably in Uruguay between 1996 and 2001, according to the ANC[21]. The reported

[20] The 11th Conference on Postal and Delivery Economics in June 2003 in Toledo (Spain) will discuss several papers on access issues in posts. The debate in higher income countries has shifted from the compatibility of competition with the USO provision to pricing issues (i.e. for retail and access products) consistent with the maintenance of the USO in a liberalised market.

figures for growth are not within the range that would be expected in the postal sector, especially given the decrease in GDP over recent years. Nevertheless, following detailed communication with the ANC, these remain the officially reported figures.

In contrast, domestic mail volumes handled by TPC in Tanzania have remained relatively constant since the reform, whilst the positive economic growth has been increasing since the mid 1990s.[22] The latest data suggest an improvement and domestic mail increased by 10% or so in 2001. Mail growth with GDP growth in the two countries are illustrated in Figure 5-1.

Figure 5-1: Total letter traffic handled by incumbent and GDP



Note: mail volumes are for domestic ordinary/ basic correspondence handled by the incumbent.
Source: TPC Annual Reports and UPU for ANC data, GDP: IMF Country Report No. 03/02 for Uruguay, Selected Issues and Statistical Appendix; LatinFocus Consensus Forecasts

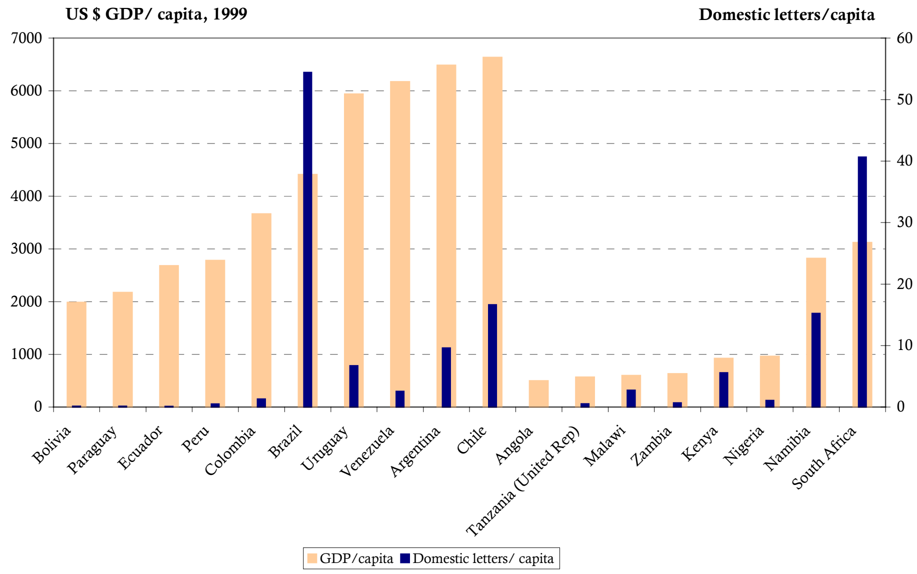
Figure 5-2 shows the number of incumbent's domestic items per capita and GDP per capita for neighbouring countries to both Uruguay and Tanzania. This fails to indicate a relationship between GDP per capita and items per capita handled by the incumbent in Latin America. This may reflect the fact that self-provision is widespread in these countries,

[21] Competitors also benefited from this increase in demand for postal services.

[22] There have been substantial real tariff increase in the basic letter service discussed in Section 4.3.

resulting in lower volumes handled by the incumbent. This comparison brings a different perspective on the low items per capita delivered by the incumbent providers in the selection of African countries.

Figure 5-2: Letter and GDP per capita in a selection of neighbouring countries



Note: letter mail corresponds to domestic letters handled by the incumbent only in 2001. It therefore excludes traffic handled by self providers and competitors. Source: UPU for mail volumes and population; and World Bank indicators for GDP per capita.

5.3.2 Productivity

Both incumbents have witnessed considerable gains in productivity over the past decade. In:

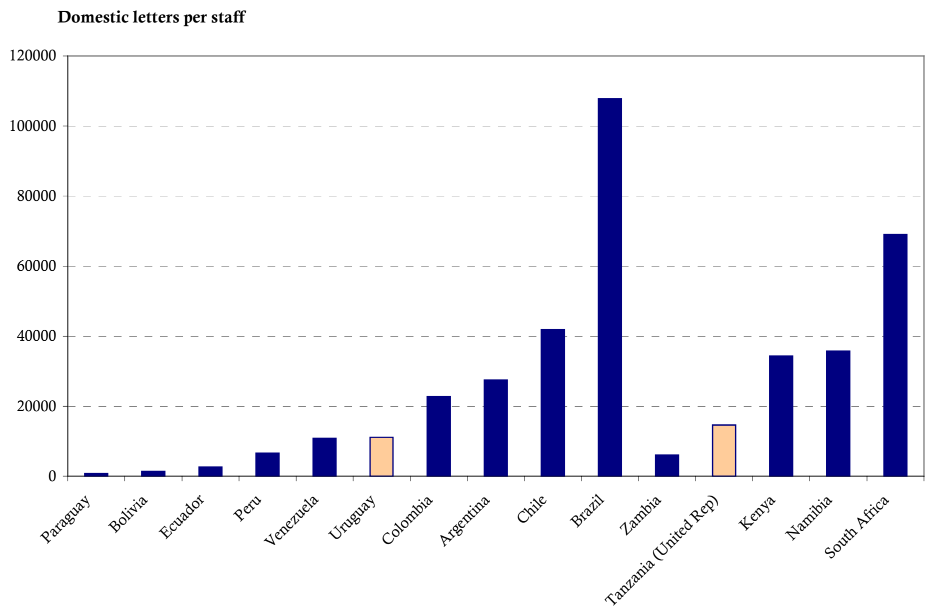
- Uruguay, in 2002, each ANC staff (permanent and contract combined) handled 11,000 domestic letter items, compared to an average of 3,650 items around the mid- 1990s;[23] and

- Tanzania, in 2002, 14,600 domestic letter items were handled per employee, an increase from about 10,600 in 1994.

[23] The main reason for the low productivity in the early to mid-1990s was a requirement for ANC to integrate surplus personnel from other state companies (*source*: ANC interviews).

The current performance levels for Uruguay are below what may be expected given its income levels. An international comparison suggests that there could be scope for further gains in productivity as shown in Figure 5-3[24].

Figure 5-3: Letter per staff in a selection of neighbouring countries



Note: traffic includes domestic standard letters only. Staff corresponds to the sum of full time and part time employees.
Source: UPU

5.3.3 *Financial viability and commercialisation*

The reforms have had a mixed impact on the financial viability of the incumbents. Despite substantial increase in tariffs in real terms for basic letter services (discussed in Section 6):

- ANC continues to receive substantial annual subsidies from the government and still make a net loss; and
- TPC has moved from making an operating loss to a small operating profit.

[24] This may also explain the financial performance of the ANC.

However, the significance of TPC's improved performance should not be overstated. The operating profit excludes the need for it to undertake any new investment or even maintain current assets—it simply reflects income that is slightly above cash-flow costs (e.g. salaries, vehicle and office operating expenses).

Neither organisation would be able to borrow money required for new investment, or the replacement of existing assets, without considerable government support. The ANC has benefited from a budget for investment from the government at the start of the reform in 1996; which has supported its quality of service enhancements. Improved productivity and higher tariffs have helped TPC to implement some of these measures but it will have to rely on borrowing to finance the required new investment. However, given the economic situation, competition in the market and lack of government subsidies to meet its USO obligations, this remains an impressive financial performance for TPC.

5.4 Key findings

The performance of the incumbents since reform provides a mixed picture.

- Volume growth has largely failed to meet expectations at the outset of the reform processes in Tanzania. In Tanzania volumes have grown very little, in line, however with economic growth. In Uruguay the ANC traffic has grown at a faster pace than economic growth since the reform. Both incumbents have increased substantially their tariffs in real terms.
- Both incumbents have improved their productivity levels substantially. In Tanzania, this has meant reducing the number of staff and in Uruguay, not increasing staff levels to handle larger volumes of mail.
- However, the overall position on profitability is a mixed picture. In Tanzania there has been a slight improvement to a point where TPC is now able to meet its cash-flow obligations without any external subsidies. In Uruguay, the ANC continues to receive large subsidies from the state and still makes a net loss. The productivity gains and increase in revenues continue to be outweighed by increases in non-staff costs[25].

[25] Largely accounted for exchange rate fluctuations.

Companies have entered the postal markets in both countries following liberalisation. In general they have focused on the more profitable inter-urban and international markets, although more widespread entry has occurred in Uruguay. In addition, in Tanzania, where an official reserved area exists to protect the incumbent's USO requirements, interviews indicated that there had been illegal entry into this reserved area. It would appear to be very difficult to enforce monopoly rights, even where they have been established in order to protect revenues required to serve customers (i.e. as part of the USO funding).

Summary: Similarities and differences between Tanzania and Uruguay	
Gains in productivity: both incumbents have improved their productivity substantially since the reforms *Nature of entry*: the strategies for entry in the letter market focussed on urban and inter-urban areas.	*Access provider*: local operators in rural areas deliver the mail of the incumbent of competitors in Uruguay while the incumbent is the access provider in Tanzania. *Financial independence*: the ANC continues to receive substantial annual subsidies and still makes a loss. TPC is now able to meet its cash-flow obligations without any external subsidy.

6. Regulatory issues

This section reviews the key institutional and regulatory issues emerging from the regulatory instruments adopted as part of the reform packages. We begin with an evaluation of the degree of independence of the regulator and the scope of its duties, including the extent to which they focus on the promotion of competition. We then review the treatment of the universal service obligations in both countries.

Overall, the regulator in Tanzania appears slightly more independent than the regulator in Uruguay. This is reflected in its ability to act autonomously and the scope of its duties. In both countries, the precise scope of the USO has been left to the interpretation of the universal service providers (public operators). While this allows them to adopt realistic targets, it may also lead to a conflict of interest because they can interpret it to serve their commercial objectives rather than the wider, customer service, objectives it is designed to meet. The public operators have concentrated their efforts on meeting USOs in terms of access provision through access to counters. The incumbents do not appear to attempt to meet a letter USO as typically defined in higher income countries, which entails providing a letter service at a given delivery standard across the country at a uniform price. This is discussed in more detail below.

6.1 Independence of the regulator's office

This section discusses the degree of independence of the regulator's office in terms of its ability to balance the requirements of all stakeholders.

6.1.1 Overview of regulatory bodies

Both countries have put in place regulatory structures that involve three levels of institutions: the president's office, a government department or ministry and the regulatory office itself. Table 6-1 provides an overview of these institutions and their role in the two countries.

A common approach in both countries is that power to approve new investment has been removed from both the operator and regulator. In Uruguay, the Office of Planning and Budgeting (OPP[26]) is responsible for proposing the level of subsidy to be transferred to the ANC, which largely determines its ability to invest. In Tanzania, the Presidential Parastatal

[26] OPP stands for Oficina de Planeamiento y Presupuesto

Sector Reform Commission (PSRC) must approve all borrowing by TPC, which largely determines its ability to undertake new investment.

Table 6-1: Overview of regulatory bodies

Body	**Uruguay**	**Tanzania**
Government	Formulate postal policy Approves incumbent tariffs through its position on the Board	Sets policy and acts as arbiter in some disputes
Other government department	*Office of Planning and Budgeting (OPP)* Propose the level of subsidy to the President's office for the ANC	*Presidential Parastatal Sector Reform Commission:* A government body that must approve borrowing by TPC and will recommend to government whether and how TPC is to be privatised. Signatory to Performance Contract that governs quality of service targets for TPC
Regulator	*Unidad Reguladora de Servicios de Comunicationes - URSEC*: Advise government on postal policy Grant licence to postal operators	*Tanzania Communication Commission –TCC* Grants licenses to postal operators Approves incumbent's prices

6.1.2 Independence of regulator

Studies undertaken by the World Bank and others, including Frontier Economics, have revealed that regulatory independence is an important determinant of new investment and private sector participation, two outcomes that tend to lead to improved service provision for customers.[27] In-line with these findings, stated objectives in both Tanzania and Uruguay at the outset of the reforms also emphasised the need to create independent regulatory institutions (see Section 3.1).

27 See, for example, "Indian Power Sector Reform Post-Orissa" undertaken by Frontier Economics for the World Bank (1999) and the international investor survey contained therein.

The degree of independence of the regulatory body depends and is defined in terms of five factors, its:

(i) status in relation to the state;

(ii) funding;

(iii) transparency;

(iv) appointment and dismissal process; and

(v) ability to define and impose sanctions.

These factors are important in determining whether a regulator is able to act independently (i.e. fairly balance the views of all stakeholders to reach and then enforce a decision), or whether it will be unduly influenced by any single stakeholder. While a regulator may be able to act independently even if it does not meet all the above conditions, it risks the *perception* of a lack of independence. This perception alone will make it more difficult to operate.

Table 6-2 indicates that the objective to create independent regulatory authorities has been partly met in both countries. The creation of agencies that are removed from government and have their own sources of funding allows them to act with a degree of independence.[28] However, there are important limitations to this independence. In common across the two countries is the powerful position of particular government officials in appointing new regulatory commissioners. Greater independence would exist if more transparent appointment processes were put in place. In addition, despite the legal authority to enforce regulatory decisions the regulators appear to have limited ability, in practice, to enforce their determinations. This is particularly evident in Tanzania where the regulator has been largely unable to prevent entry into the reserved area.

28 Although in Uruguay some funding comes from the Government.

Table 6-2: Relative independence

Area	Uruguay	Tanzania	Best Practice
Level	Agency outside of government has been created Regulator reports to Office of the President	Agency outside of government has been created Regulator reports to Ministry of Telecommunications and Transport	Agency outside of government
Funding of regulator's office	Government budget	License fees and royalty payment from incumbent	Industry levy
Transparency	Good process for licence applicants and use of legal framework for major decisions	Good communication between commission and operators but less transparent for public, reasoning behind tariff decisions only published at one review	Establish clear communication between regulator and all stakeholder groups, publish consultation, discussion and final documents in accessible format (e.g. on web, available at office)
Appointment /dismissal	Appointment by President's Office	Chairman appointed by President and commissioners by Minister of Telecommunications and Transport	Transparent rule based system
Ability to define and impose sanctions	Law provides for penalties for breach of licences and poor service to customers	Law provides for specific punishments (mainly fines) but in practice regulator finds them difficult to enforce	Clear right of regulator to impose fines with quick judicial process for companies to appeal and for regulator to enforce

6.1.3 Functions of regulators

There are differences in regulatory responsibilities, which reflect the different focus of the regulatory regimes and the different approach to postal reform adopted by the two countries. Postal reform in Uruguay has supported the introduction of competition to meet consumer needs, while the reforms in Tanzania were focused on the creation of a commercially viable public operator able to meet the requirements of consumers.

Legal clarity of the duties of the regulator

Both regulatory bodies, TCC and URSEC, have responsibility for the telecommunications and postal sectors. In both countries, the focus of the regulatory authority, in terms of time and the skills of its staff, is overwhelmingly towards the telecommunications sector. This may be at the expense of developing an appropriate regulatory framework and driving through reforms in the postal sector.

For example, while URSEC was set clear and specific responsibilities in the area of telecommunications, its duties towards the postal sector are left considerably more vague[29]. URSEC's postal duties are limited to:

- establish regulatory norms of postal services;
- license the provision of postal services and monitor compliance;
- act in the defence of consumers where justified complaints exist; and
- advise the President's office on issues relating to postal policy.

Essentially, its main duty lies in the development of competition by licensing competitors, with some *ad hoc* duties to help consumers in the case of conflicts and support the government in the formulation of policy. The 1996 law that began the reform process liberalised the sector but did not define the regulatory responsibilities or give the authority to manage the marketplace that was to be developed. This led to an incomplete legal reform, which was partly remedied in 2001 with the creation of the separate regulatory authority (see Figure 3-1).

In contrast, the postal functions of the TCC are set out in detail in the *Tanzania Communications Act 1993* as shown in the box below.

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[29] Decree 212/001 and Law 17, 296

Functions of the TCC

The functions of the TCC are set out in Article 5(1) of the Tanzania Communications Act 1993:

- to ensure that there are provided throughout the United Republic good and sufficient domestic and international …postal services and such other services on terms as the Commission may think expedient;
- without prejudice [to the above] …to ensure that any person by whom any…postal services fall to be provided is able to provide these services at rates consistent with efficient and continuous service and necessity for maintaining independent financial viability;
- to promote the development of … postal systems and services in accordance with, practical recognised international standard practices and public demand;
- to exercise licensing and regulatory functions in respect of …postal systems in the United Republic …;
- to regulate the fixing of rates of postage and other fees or sums to be charged in respect of postal articles sent under this Act;
- to regulate the fees and commissions on postal financial services;
- to regulate the performance of postal financial services on behalf of government and non-government agencies;
- to regulate the issuance of postal stamps including definitive commemorative and special issues of postage stamps and any other philatelic items;
- to promote competition in providing…postal services;
- to secure that reasonable demands for … postal services are satisfied;
- to promote and encourage the expansion of …postal services with a view to the economic development of the United Republic;
- to further the advancement of the technology relating to the …postal systems and services;
- to act internationally as national body representative of the United Republic and in respect of … postal matters; and
- to advice the government on all …postal matters and on matters pertaining to the Commission generally.

Price regulation and licence regime

TCC both regulate the incumbent's prices and grant licences to operators in the non-reserved area. It must approve the incumbent's prices, and ensure they are compatible with its USO and other obligations. URSEC has a more administrative role and grants licences to all operators handling items of correspondence.[30]

The lack of price regulation in Uruguay is not necessarily problematic. The regulation of the ANC's prices may not be necessary as long as rival operators can restrict the ability of the incumbent to raise prices above the competitive level. Analysis of the profitability figures in Section 5 indicates that on average the current level of prices of the incumbent do not appear to cover the cost of operations, and the ANC has been prevented from increasing them to cover costs by competition.

Finally, in addition to the pricing discipline created by competitors, ANC's prices are regulated through its ownership structure. ANC is owned by the government, which undertakes many of the roles reserved for the regulator in Tanzania—including the control of prices to protect consumers. This less explicit regulation is achieved through the government's control of appointments to the Board of ANC.

Quality regulation

Further differences in both regulatory regimes emerge in the oversight and enforcement of quality of service targets. An explicit Performance Contract between the TPC and a government oversight body (the PSRC) sets targets for quality of service, along with bonuses and penalties for TPC senior management staff (see Section 4.2). No such explicit instrument exists in Uruguay.

Maintenance of the financial viability of the universal service provider

The TCC is explicitly required in the Act to ensure the maintenance of the financial viability of the universal service provider. Such duty is not required from the URSEC in Uruguay. This duty is left with the Uruguayan government. This is compatible with the different regulatory frameworks under which URSEC is focused on increasing competition, while the TCC's main focus is on creating a viable public operator.

[30] i.e. excluding operators that deliver their own invoices

6.1.4 Actions of regulators

This project did not include an evaluation of the effectiveness of the regulatory agencies (i.e. their ability to meet their objectives). The only possible analysis of the effectiveness of the regulators in the context of this study is the analysis of the market outcomes. Therefore, it is difficult to make definitive statements about each regulatory agency. It is particularly difficult in the case of URSEC because it was only created in 2001. However, a number of market outcomes do illustrate that the different focus of the regulatory regimes has had an impact:

- **New entry in Uruguay**: no new licenses were issued in Uruguay between 1996 and 1999, when the ANC was responsible for both operations and regulation. Since the creation of URSEC in 2001, 36 new licenses have been issued, illustrating its focus on supporting new entry and competition in line with its duties in running the licence regime.

- **Price reviews in Tanzania**: the focus of the TCC on reviewing TPC's tariffs is evident in the series of price reviews that have been held since its creation. These have allowed tariffs to keep up with inflation and, more recently, to increase in real terms, which are consistent with the objective of making the operator financially independent. Again this is in line with TCC's duties.

In other areas, the effectiveness of the regulatory agencies has been more limited. This is particularly noticeable in Tanzania where the TCC has found it difficult to effectively enforce the reserved area that is intended to allow TPC to cross-subsidise loss making routes and thereby meet its USO commitments. In Uruguay, the focus of the regulatory authority on telecommunications rather than the postal sector may limit regulatory focus on providing incentives for the incumbent to improve its efficiency in order to decrease government subsidies.

6.2 The USO

The treatment of the USO is critical to the development of the postal sector. It impacts the public operator, new entrants and customers.

6.2.1 Guidance by the regulators on the definition of the universal service obligations

The two countries have adopted different approaches to the definition of the USO. However, they share in common the lack of a very detailed definition of the requirements expected by the regulator from the universal service providers (i.e. the public sector incumbents in both countries).

In Uruguay there is no formal definition of the USO in terms of mail included or weight of items (e.g. all letters and cards up to 2 kilograms), nor is the USO defined in terms of minimum acceptable levels of access to postal services. The main reference is to the broad mission of the universal service provider as stated by the Universal Postal Union (UPU). The OPP is currently reviewing this definition and investigating alternative definitions of the USO.[31]

In Tanzania, the USO is mentioned in the legislation, TPC's licenses and some regulations but only in very general terms. The most concrete definition is contained in the license which requires TPC to "*provide postal services at a regulated fee to any person who requests for such services at any place in the United Republic*" (Part 2(1)). Under this part of the license "*postal services"* refers to the conveyance and delivery of letters domestically and internationally. However, there is no guidance about how to implement this definition.

These loose definitions may reflect governments' concern over the cost of the USO if precisely defined, or a lack of knowledge over what the cost of alternative specific definitions would be and the implications for the development of the sector. Consequently, the governments have allowed operators to implement general requirements in a manner that meets a general duty to provide universal service within the financial resources of the corporation. However, this approach does leave consumers and the regulator with very little scope to challenge the level of service the operator then chooses to provide. It also inhibits any opportunity to modify the USO parameters by reducing or increasing the weight/ price restriction or access points within a transparent regulatory framework as customer needs change.

6.2.2 Operational definitions of the USO

In both countries, the interpretation of the USO has been broadly left to the universal service providers. Both have developed operational definitions of the USO, with a prime focus on the provision of nationwide access to postal services (i.e. access to counters facilities). Neither incumbent has implemented a USO that combines a commitment for: a specific letter delivery service and a fixed uniform (geographically averaged) price. This is the typical definition of the USO in higher income

31 We understand that a Technical Assistance Loan from the World Bank, that includes this work, has been initiated.

countries but, for reasons discussed below, was not considered appropriate in either Tanzania or Uruguay.

The operational definition of the USO developed by the ANC, provides:

- 6-day delivery service (Monday to Saturday) across the country at a uniform tariff with a different speed of delivery according to whether the ANC undertakes the delivery or contracts it to another local operator; and

- the provision of access through a network of corporate (own) offices and *Agencias a Comisión* (franchised agencies) in pharmacies, tobacconists, drugstores and similar establishments that allow the provision of postal counters services in suburban and rural areas and drop mail.

In contrast, TPC appears free to decide on issues such as: where to locate post offices, the type of post office to put in place and the level of service provision (e.g. location of collection and delivery). TPC has developed three distinct forms of post office designed to serve communities and areas with different characteristics: TPC owned and operated, franchised and owner-operated.[32] The TPC owned and operated offices tend to serve larger, busier areas with the franchised offices serving slightly smaller markets and the owner-operated offices serving small villages and other rural areas. The Performance Contract (see Section 3.3.2) also provides for different levels of service in different parts of the country and so the service obligations under the USO are not uniform, although tariffs remain uniform. This may be reasonable in a country with such a dispersed population.

6.2.3 Cost of the USO

The development of the USO in both countries requires a distinction between access (i.e. counters) and delivery (i.e. mail). Below we examine these two areas separately.

Counters

An economic definition of the cost of the USO with respect to counters incorporates the required maintenance of a counters presence despite the

[32] The difference between franchised and owner-operated offices lies in the ownership of the office building and related physical assets. Franchised offices are still owned by TPC but operated by non-salaried individuals who receive a commission from TPC based on sales revenues. Owner-operated post offices are owned and operated by independent individuals who received a commission from TPC based on sales revenues.

fact that it is not profitable. This study has not explored the cost of the counters USO. However, we believe that incumbents have adopted a strategy of franchising their networks to minimise costs. The extent to which this aim has been achieved depends on the terms of payment to the franchisees for their services.[33] Further research is necessary to evaluate the cost effectiveness of this approach. We note this access provision has increased over time in Uruguay but reduced recently in Tanzania.

Letters

The economic definition of the cost of the USO with respect to the delivery of letters incorporates the combined requirement of a uniform tariff and a uniform quality of service across the country, despite the fact that certain areas are more expensive to service. The result is a loss made by the universal service provider in some areas of the country and a profit in others. The level of cross subsidy and ability to maintain the USO within an increasingly competitive market depends partly on the degree to which delivery costs vary by region. The ToR for this study do not include such an analysis, however we note that Tanzania has adopted a more flexible definition in order to ensure the costs of the USO are reasonable. TPC offers a uniform tariff but commits to a different speed of delivery depending on the destination of the letter. This approach makes the provision of the USO less onerous on the provider. The same approach is adopted by the ANC.

6.2.4 Funding the USO

The two countries have adopted different approaches to financing the incumbent's USO provisions. Tanzania relies on the universal service provider funding internally the costs related to meeting the universal service obligations from revenue produced in its reserved area. In Uruguay, an external funding of the USO cost has been adopted and relies on general taxation raised by the government, and not from licensing, other fees or a reserved area. Each is discussed in more detail below.

[33] For example, we understand that in Uruguay the ANC pays the franchisees, who also deliver mail on behalf of the incumbent, on a per item basis at a rate of about 20% of the public tariff for a letter. Equivalent information for Tanzania was not available.

Tanzania

In Tanzania above-cost pricing on items falling within the reserved area is intended to cross subsidise loss-making routes that form part of the incumbent's USO. In practice, there have been two problems with this:

- prices within the reserved area do not appear to be noticeably above cost, with unit cost estimates of about TSh 500 and prices ranging from TSh 300 to Tsh 1,600, with the bulk of items being at the lower end of this range;[34] and

- some licensed operators appear to be also operating within the reserved area (i.e. they infringe the monopoly), decreasing TPC's potential earnings.

As noted above, evidence from Tanzania suggests that it is quite difficult to enforce a reserved area that is defined by weight. Consequently, in 2001, the regulator put in place a price limit, stating that only the incumbent can price below Tsh1,000.[35]

Uruguay

Uruguay's postal delivery service is fully liberalised. The license regime allows new entry into the whole postal market with no protection for the incumbent operator.[36] USO funding in Uruguay comes directly from the government in the form of an annual subsidy. The government has been trying to eliminate this subsidy over the past few years but had to increase it following the abolition of a license fee on private operators in 2001. In the absence of the subsidy it is not clear how the ANC would finance its operations, including maintain a universal provision, although it is important to note that the high degree of urbanisation in Uruguay means that there may not be substantial excess costs associated with the USO.

[34] It should be noted that if the regulator determines the high unit costs are a consequence of inefficiency rather than costs associated with the USO then there is no reason for it to set prices at a level that would meet these costs.

[35] The legal definition of the reserved area remains unchanged, at 500 grams, in the regulations. The definition of the Ths1,000 limit is a recognition by the regulator that it was unable to enforce the weight limit and an attempt to try an alternative approach.

[36] Greater control of new entry was considered in a 1998 Bill that was never enacted.

6.3 Key findings

Both Tanzania and Uruguay have met their objective of setting up separate regulatory bodies, although there continues to be some question over the degree to which they are able (or, at least, perceived to be able) to act independently. Their duties differ substantially with the additional focus on tariff setting in Tanzania that the Uruguayan regulator does not handle.

Both countries have allowed the operators considerable discretion in their interpretation of the USO and have adopted different frameworks for funding the resulting USO: [37]

- in Tanzania, a reserved area is used to try to protect the incumbent with the USO from competition in part of the market; and
- in Uruguay government subsidies are provided to the incumbent with the USO obligation.

The costs of the counters USO are most likely to be related to the maintenance of the physical network. This in turn will largely depend on the payment terms to the agencies (i.e. franchises) acting on behalf of the incumbent.

Both incumbents have adopted a flexible interpretation of the USO for letters delivery. In Tanzania, TPC offers a uniform price but delivers at different speeds to different regions. This approach appears to be a sensible response to a large country with a small demand for postal services. The concern in Uruguay may be less prevalent as the population is highly urbanised, suggesting a limited number of destinations whose delivery cost is well above the national average delivery cost. Nevertheless, we note that the ANC offer two speeds of delivery for its basic letter service, which is charged at a uniform rate.

[37] We note that this is not uncommon in the postal sector.

Summary: Similarities and differences between Tanzania and Uruguay	
Similarities	**Differences**
Regulatory structure: both have created separate regulators, along with a government agency that oversees new investment and a government ministry overseeing competition *Regulatory independence*: both regulators operate independently but have their powers curtailed by specific institutional factors (e.g. difficulty enforcing rulings in Tanzania, funding mechanism in Uruguay). *Legal definition of USO*: neither country has a well developed legal definition of the USO and in both cases the incumbent public operator is left to decide how best to operationalise the USO *Operational definition of USO*: both universal service providers offer a national service at a uniform price but varying quality (e.g. speed of delivery to different regions varies).	*Regulatory duties and focus*: the focus of URSEC in Uruguay is licensing new entry and preserving a competitive market; the focus of TCC in Tanzania is regulating the price of the incumbent, along with licensing *Funding of USO*: a reserved area has been created in Tanzania and no subsidies are provided from government; there is no reserved area in Uruguay with all funding coming from a government transfer

7. Conclusions

This section summarises the key themes and lessons that emerge from these case studies. These are related to the scope and implementation of the reform programme and then the market outcomes for both operators and customers; and lastly fulfilment of social obligations. It highlights some of the necessary features of the reform programme and recommend topics for further research. This additional research is intended to provide the evidence required to decide whether the lessons emerging from this study can be generalised into a more widely applicable strategy for postal sector reform.

7.1 Reform programme

Objectives and focus of reform programme

In the two case studies, the objectives of institutional changes have been met. Both reforms have led to the creation of separate regulatory agencies from government and incumbent and to a change in the status of the incumbents with the aim of providing more commercial freedom to achieve financial independence and greater commercialisation.

However, neither reform programme set clear objectives for the reforms in terms of expected outcomes for customers. Therefore, the impact of the reform can only be evaluated only through an analysis of market outcomes and impact on the incumbent. To strengthen the robustness of an evaluation of the impact of reforms, it would be helpful to consider setting out the expected benefits for customers at the outset.

Independent Regulator

The independence of the regulator has broadly been achieved in both countries. The independence of regulator from a group or a single stakeholder is important to send the right signals to postal operators and customers.

The clarity of the powers and duties of the regulator was not consistently achieved across both countries. In Tanzania, the duties of the regulator were detailed in the Act. In Uruguay, the terms were more vague. Again, the clarity of the duties for the regulator sets the remit of its functions, and its actions can then be evaluated against its legal duties. This provides certainty for operators and the possibility to challenge decisions of the regulator if necessary.

Lastly, the effectiveness of the regulator rests on the agency gaining postal expertise. The special features of the postal sector ought to be taken into consideration for formulating relevant and appropriate policies by the regulatory functions.

Financially self-sustainable incumbent

The improvement in the financial position of incumbent remains mixed about a decade after the start of reform in Tanzania and half a decade after reforms in Uruguay. TPC has recently achieved an operational profit in combining sharp increase in productivity and large increase in tariffs in real terms. The ANC continues to make losses and to require large government transfer. Its gains in productivity have been large but from a low base. Hence the level of the costs remains high and outweighs revenues, which have also been boosted by real tariff increases.

7.2 Market outcomes

Liberalisation

The reforms have formally allowed full entry in Uruguay – although it has been effective only since 2001 when the regulator was put in place. In Tanzania, a reserved area has been defined and operators can enter the market above the defined monopoly threshold.

Rival operators have entered the postal market in particular in Uruguay, with 36 licences granted since 2001. The fact that much of this new entry has only occurred over the past 18 months or so may be partially responsible for the relatively high prices that prevail (see Section 4.3). New entrants have been in a position to provide a nationwide service to their customers in part because of the access terms provided either by the incumbent or local operators for the final delivery. This market outcome confirms the view that access arrangements may develop within a liberalised market to allow efficient competition.[38] This supports the view that an access regime may support entry – at least in countries with large variation in delivery costs across regions.

In both countries, operators compete with the incumbent and provide an end-to-end service in urban/ high-density areas. Their services are mostly purchased by customers living in urban areas who, with higher incomes, can afford the more expensive products provided by rival operators which offer higher reliability and faster services.

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[38] Given data availability it was not possible to determine whether efficient access prices were being charged.

Incumbents meeting future demand

Both reforms have concentrated on legal changes for the incumbent. Both incumbents have changed status and gained a degree of freedom. The reform did not set a path for commercialisation to support the achievement of a financially independent operator – at least in Uruguay. In Tanzania, the performance contract provides tools and incentives towards this goal.

Incumbents have responded to competitive pressures in Uruguay or to incentive scheme in Tanzania through a programme of productivity gains and rationalisation, and greater efforts to improve quality of service. The shift of focus towards the identification of revenue opportunities has just started (e.g. financial products). This will require a good assessment of customer needs and the costs of meeting these needs. In particular, we note that large businesses rely on the incumbents for their domestic basic letter services and their future needs may change as these countries become richer.

Outcomes for customers

Following the reforms, we note that customers in urban areas have benefited from a wider choice and access to postal services, whilst the benefits for customers in remote areas have been more muted.

Customer behaviour in both countries suggests that there is a group of households and small businesses that are willing to pay higher tariffs than the incumbent's to obtain higher quality and more reliable service.

A potential concerns remains around the affordability of postal services for all households. Both incumbents have increased tariffs to improve their financial position with the approval of the regulator in Tanzania, and the board in Uruguay. Improved measurement of traffic volumes by each incumbent would help to estimate price elasticities of demand and to better inform pricing decisions.

7.3 Social obligations: the USO in posts

In both countries, the definition of the universal service obligations was vague in the legal texts. The lack of guidance in the legislation and other legal documents, guidance from regulator or government on the implementation of that definition was limited. Consequently, the public operators, who have a USO under their license, were left to design the operational features of the USO.

The scope of the USO ought to reflect customer needs and the financing options. Hence the USO interpretation and scope should involve and be agreed among all stakeholders in the sector to reach the appropriate balance between customer needs and constraints on the universal service provider and on the sector. Ideally such definition would set out the service which need to be provided on a universal basis, the required pricing rule and standard of service. It should also stipulate the funding mechanisms (i.e. the scope of the reserved area or general taxation).

Both incumbents have focussed their efforts in providing a nationwide access network with a physical presence through owned or franchised counters. The USO for the delivery of letters at a uniform price at a standard quality of service across the country has not been adopted for basic letter services. Incumbents have made this provision less onerous in adopting a uniform price but different speed of delivery. Mail in more remote areas can take longer to reach their final destination by one day or so when compared with mail in urban area. This interpretation of the letter USO appears sensible in large countries where demand and delivery in rural areas is low.

We note that incumbents have also taken measures to reduce the burden with the provision of a nationwide post office counters. The strategy has been to rely on franchises, in particular in Uruguay. Since this strategy has been followed by several developing countries, on all continents, as one means of introducing private sector participation, it would be helpful to undertake some research on the payment terms and incentive mechanisms negotiated between the incumbent and its agents, to ascertain the extent to which this approach can or has reduced substantially the burden. Equally, it would be useful to evaluate the cost of the USO for the provision of a nationwide letter service. These two costs assessments could bring some light on the size of funding requirements from the state or the incumbent though internal funding and on the level of the efficiency of the universal service providers.

7.4 Recommendations for further Research

These case studies have identified some features across the two countries, which need further research to determine the extent to which the lessons from these case studies can be generalised and used to develop a broader strategy for postal sector reform.

- *USO definition, cost and funding*: different definitions of the USO for the provision of a letter delivery service in terms of products and pricing restrictions imply different burdens for the USP, and therefore call for different levels and mechanisms of funding. In both countries the interpretation of the USO led the USPs to offer a uniform price but a varying standard of service across the country. Costs and the funding of the USO have important implications for the degree of liberalisation that may be considered. As a result, it would be helpful to assess whether this flexible interpretation of the USO is common practice in developing countries, draw the implications for the cost of the USO and investigate whether this approach is able to meet customer needs.

- *Franchised post offices:* USPs in both countries rely on franchises for enhancing access to counters facilities. This strategy will achieve its aim of cost minimisation if the payment terms and incentives to franchises are appropriate. Limited data was available to determine whether this was a case for the countries in this study. It would be useful to review the outcome of this strategy in more detail.

- *Access regimes:* the ability of new postal operators to provide services on a national scale to their customers may be enhanced through the provision of an access regime to the delivery facilities of an established operator(s). Such development is being considered in Europe as the market is gradually liberalised. In developing countries, such regimes might have developed informally, as in Tanzania and Uruguay. The demand for such services and the conditions under which they are offered would merit further research. This should encompass considerations about the extent of economies of scale and their impact on access charges and cost recovery by the incumbent.

- *Scope of regulators duties:* the establishment of independent postal regulators requires careful attention to the definition of their duties and powers. These need to be set out within a broader sector policy framework at the outset of the reform programme. The two regulators examined in this study had very different duties. A larger sample, or more detailed study, should examine whether one approach is better for consumers.