

CONSULTATION RESPONSE



Ofcom
Dept Competition Policy

By e-mail

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Securing the Universal Postal Service

Which? is Europe's largest independent consumer representative organisation. We are a non-profit making charity, wholly funded by the sale of Which? magazine and other related products, with over 700,000 members.

To date, Which? has had limited involvement in postal services, largely because dedicated consumer representation existed. The current uncertainty in the consumer landscape and the significant and radical nature of Ofcom's proposals oblige Which? to make a limited response. Please contact John Holmes if you have any questions about this response.

We note that the principal focus of Ofcom is to regulate Royal Mail in a manner that is most likely to secure a viable universal postal service (the universal service). The universal service requires Royal Mail to meet set standards for collection and delivery of letters and certain packages anywhere in the UK at a uniform price (national pricing). This is challenging given the reported financial weakness of Royal Mail, its need to improve efficiency and its falling revenues from the growth of rival service providers and substitute products.

Ofcom proposes that Royal Mail should exercise much greater commercial freedom in the future, able to independently set its prices across wholesale and retail services. This comes with three broad measures:

- regulatory monitoring, with the threat of re-regulation should Royal Mail exploit customers or rivals;
- a cap on the price of second class stamps for standard letters, allowing prices to be set higher than current prices but then holding constant in real terms; and

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- competition, through obliging Royal Mail to offer access to its network with conditions to prevent margin squeeze.

Our comments focus on some aspects of Ofcom's proposals and the wider implications of price liberalisation of Royal mail for consumers. We have not formed a view as to whether Ofcom's approach overall is an appropriate alternative to traditional monopoly regulation. However, given Ofcom's decision to adopt this novel approach, we expect Ofcom to be attentive to market developments and responsive to cases where Royal Mail's conduct may be harming the interests of consumers.

Specific regulatory proposals by Ofcom

- Price cap for second class stamps

We can not comment on whether the proposed starting range of 45 - 55 pence for second class letters is appropriate: there are several redactions from the consultation of financial information and there appears to be no reasoning given for this starting range. We note, however, that it is 25 per cent more expensive before any further index price changes are made.

Ofcom should adopt CPI as the basis for indexation of second class stamps, instead of RPI.

There are two main reasons:

- CPI is the government's preferred measure of inflation and affects a range of social security payments
- RPI is generally higher than CPI, with evidence of a greater and significant divergence between these measures in the future, which will lead to higher price increases that are not justified on any sound policy or methodological basis.

The Government announced in June 2010 that it would adopt CPI for indexation of benefits, tax credits and public service pensions from April 2011.¹ This followed a long standing requirement of the Bank of England to target CPI at an annual rate of 2 per cent. Commentators have reported that changes to the indexation of benefit payments, linking them to CPI away from RPI, will have a material effect upon the income of those households relying on social security, usually leading to lower income.²

¹ Paragraph 1.43, Budget, June 2010 (http://www.hm-treasury.gov.uk/d/junebudget_chapter1.pdf)

² For example, see TUC blog at <http://touchstoneblog.org.uk/2010/06/the-difference-between-rpi-and-cpi/>



In addition, there is growing evidence that estimates of average price inflation is different between RPI and CPI by a significant margin and that this ‘wedge’ will remain in the long run. In November 2011 the Royal Statistical Society hosted a meeting to review the use and differences of RPI and CPI, with a view to establishing a regular user group meeting.³ Participants noted the divergence between RPI and CPI and that the ‘formula effect’, that is the basis on which individual prices are averaged into the aggregate price inflation estimate, had the most significant impact.⁴ In the same month a working paper by the Office for Budget Responsibility reviewed in detail the differences between these measures.⁵ It estimated a long-run difference of 1.4 per cent between RPI and CPI, with RPI consistently greater than CPI.

This evidence indicates that price rises indexed to RPI will rise faster than the income of those reliant on social security, which is indexed to CPI. Over time the compound effect of an RPI indexation will lead to a material difference in the price of second class stamps compared to their price under CPI indexation. More broadly, current inflation levels (under either measure) significantly exceed wage growth which is likely to remain weak for a significant period.

Taken together, these factors strongly support the use of CPI as a method of indexation for the price cap of second class stamps. Ofcom’s proposals will only protect consumers from price rises for second class stamps. It is important, therefore, that this cap is set on a sound and reasoned basis. Ofcom’s current explanation, that RPI has been the measure of inflation traditionally used by sectoral economic regulators, is not a sufficient reason.

- Risks to consumers from end-to-end competition

We note that Ofcom is empowered to require rival postal operators to notify it should they plan to offer end-to-end postal services in competition to Royal Mail. Ofcom would review these proposals under its duty to preserve a viable universal service.

It is not clear to us how a rival end-to-end postal service may operate efficiently or effectively in consumers’ interest. Which? has significant experience of dealing with utility markets where competition is manifestly failing. Competition in other public services has not served consumers well, for example the Competition Commission has recently concluded that competition in the

³ <http://www.rssenevents.org.uk/events/20111028>

⁴ The formula effect arises from the use of a geometric mean in the CPI, which allows for the substitution by consumers to other products when facing a relative price change, compared to the sole use of an arithmetic mean in the RPI method.

⁵ *The longRun differences between RPI and CPI inflation*, working paper no. 2, November 2011, OBR (<http://cdn.budgetresponsibility.independent.gov.uk/Working-paper-No2-The-long-run-difference-between-RPI-and-CPI-inflation.pdf>)



bus market is failing. We are therefore concerned that any competitive process for a utility service, in this case postal services, is properly implemented to empower and protect consumers. Ofcom should review any notification for rival end-to-end services on a number of criteria, including:

- the impact on price transparency
- the levels of consumer protection and for privacy and redress if things go wrong
- the level of service offered to consumers
- the impact on those consumers wishing to remain with Royal Mail

Ofcom should also be prepared to actively use its sectoral, competition and consumer enforcement power to intervene where conduct or other failings undermine benefits for consumers.

Incentives on Royal Mail under a liberalised pricing structure

A de-regulated service provider, in particular if it retains a monopoly over some services, may find it beneficial to worsen its service to consumers, through changes to price and quality. Ofcom must be vigilant that Royal Mail does not use its market power and the freedom that these reforms propose to exploit consumers. The following issues warrant specific attention from Ofcom in coming months.

- Standards of performance, including complaint handling and redress, must be improved for residential customers

A recent Which? survey found significant shortcomings in the current service.⁶ Over 70 per cent of respondents reported receiving post for another address or late in the previous 12 months. A quarter of respondents felt they had cause to complain to Royal Mail, and of those that did (12 per cent) only two-fifths were satisfied with how the outcome of the complaint. The pressures on Royal Mail to cut cost while raising prices may further threaten existing poor service quality while exacerbating dissatisfaction with their business. This loss of confidence may threaten Royal Mails' viability as a universal service provider.

⁶ A survey of 2561 people, representative of GB public, was conducted in May 2011. The results were reported in a Which? article *Third Class Post?*.



- Measures to improve transparency of pricing structures

There is significant scepticism over whether Royal Mail should be allowed to set the level of its own prices.⁷ However, there is also a problem with the existing structure of prices. Pricing by size and weight has been described by one Which? member as ‘absurd, complicated and confusing’.⁸ Sixteen per cent of respondents to Which?’s survey were required to pay additional charges due to incorrect postage paid. Only 1 per cent of respondents knew the exact value of postage required. It is unacceptable that postal services should have a charging structure that results in such a high frequency of additional charges and manifest uncertainty of what prices should be. Regardless of commercial freedom by Royal Mail to set its charges, it must do so in a way that is clear, fair and not misleading. The prospect of introducing competition into this environment risks serious consumer harm.

- Hidden charging

It is clear that consumers do not understand, or easily able to calculate, the correct amount of postage in many cases. This can result in additional fees for delivery, payable by the recipient. These fees already exceed the actual costs of postage by a significant margin (over 100 per cent). There is no information on the level of fees easily available.⁹ This should be remedied now.

Which? has highlighted a number of cases where hidden charges are clearly exploiting customers.¹⁰ Certain sectors have adopted pricing models that purposefully segment prices, which has a proven harmful impact on consumers’ ability to easily compare prices and distorts their ‘willingness to pay.’ Royal Mail may have an incentive to introduce further complex or hidden pricing and to raise these prices, to avoid its ‘headline’ price rising even faster. Ofcom must be vigilant and act immediately to stop this if evidence of this conduct comes to light.

⁷ For example, over 70 per cent of respondents to a Which? online poll did not think Royal Mail should set its own prices (<http://conversation.which.co.uk/money/royal-mail-ofcom-proposal-price-rise-first-class/>).

⁸ See attached article *Third Class Post?*, August 2011, Which? Magazine.

⁹ Using a quick online search of Royal Mails’ website (accessed 5 January 2012), no specific information on the level of fees could be found, either in the ‘pricing made easy’ pdf download or on the ‘paying your fee’ part of the website (<http://www.royalmail.com/discounts-payment/fee-pay>).

¹⁰ For example, the Which? super complaint about excessive debit and credit card surcharging that the Government recently announced it would ban.