



**Australian Government**  

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**Department of Communications**

Mr Jason McNamara  
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Dear Mr McNamara

**Modernising Australia Post: Regulation Impact Statement – final assessment second pass**

I am writing in relation to the attached Regulation Impact Statement (RIS) which analyses the impacts of reform of Australia Post's regulatory requirements. Thank you for your prompt first pass assessment of the RIS.

I am satisfied that the RIS addresses the issues raised in your letter of 27 April 2015, with further analysis included as outlined below. The change in regulatory burden on Australia Post has been quantified and agreed using a costing methodology agreed with your Office.

The RIS has also been amended to reflect the Cabinet's recent policy approval on the delivery speed and frequency requirements for the Priority letter service. An explanation of this change has been included in the RIS. A copy of this approval is attached to this letter.

Accordingly, I am satisfied that the RIS now meets best practice consistent with the *Australian Government Guide to Regulation*.

The issues raised in your letter have been addressed as follows:

**1. Introduction of competition into the letters market**

As part of the impact analysis, the RIS discusses the potential and likely benefits of competition in the letters market. Deregulation is likely to result in only limited competition in the letters market, which is declining due to competition from increasingly sophisticated and ubiquitous digital alternatives. The ongoing reduction in letter volumes is likely to deter the entry of competitors given the high uncertainty over an adequate return on investment. Potential competitors will also face significant barriers to entry to the letters market such as high upfront investment, network size and the need to interconnect with other postal networks. Australia Post's established brand name and national network also provide it with significant competitive advantages.

New market entrants are more likely to only offer services in low cost, high revenue areas with higher profit potential (e.g. large metropolitan centres). This conclusion is supported by international experience with the introduction of competition. For example, Deloitte Access Economics found that, in those countries where competitors have gained higher amounts of market share, they have limited operations which do not cover the whole country except in countries with small geographic areas and high population densities.

The RIS includes more detailed information on the impact of this limited competition on consumers, businesses, Australia Post and other key stakeholders. Such competition would benefit some consumers with lower prices and/or an improved range and diversity of services. This would provide a competitive advantage to businesses operating in those areas but, in some cases, may also reduce incentives to migrate to digital alternatives and achieve potential efficiency gains. While senders of letters in some areas would benefit by using the new entrants, others may face increased postage costs as Australia Post raises prices to mitigate its losses.

Competition would result in reduced revenues for Australia Post, further exacerbating its deteriorating financial position. As Australia Post would have an ongoing Community Service Obligation (CSO) to service all areas of Australia, this outcome would diminish its capacity to cross-subsidise higher-cost elements of its letters network (including regional, rural and remote areas) with profits from more profitable elements.

Such an outcome would increase the urgency for further regulatory reform and may lead to Australia Post requiring a funding injection in the medium term (e.g. through asset divestment, debt funding or an approach to the Australian Government) to enable it to continue to provide the CSO.

It is also worth noting that, while there is no direct competitor in the regulated letter market that is not to say that Australia Post operates without any incentive to be efficient. The loss-making nature of the CSO, and the need for Australia Post to cross-subsidise the letters business from the competitive segments of the business, gives Australia Post a significant incentive to operate the letters network as efficiently as possible.

## **2. Mail service as a public good and Australia Post's CSO**

With regard to whether the basic mail service is a public good, the RIS notes that while the service may have some elements of a public good, it also contains characteristics which prevent it from being classified as such. While a public good is non-excludable (that is, individuals cannot be excluded from consumption), consumption of the letter service is restricted to those willing to purchase the service, effectively excluding those consumers who are not willing to pay. Furthermore, the major benefits of mail are captured by direct participants in the transaction (the sender and the recipient).

The RIS outlines the policy rationale for Australia Post's CSO. The CSO obligation was imposed in recognition of the importance of providing an acceptable letter services to meet the social, industrial and commercial needs of the Australian community. The CSO requires Australia Post to provide a national letter service that is "reasonably accessible to all people in Australia on an equitable basis, wherever they reside or carry on a business", and which is available at a uniform rate of postage.

The original intention was that profits from Australia Post's reserved services would be sufficient to fund its CSO costs. However, due to declining letter volumes, the domestic reserved letter service has operated at a loss since 2008–09, with the shortfall funded by profits from Australia Post's commercial activities. These profits are no longer sufficient to cover the increasing losses in the letters business.

While the Australian Government could directly fund Australia Post's letters business, this would not address the fundamental structural issue of declining letter volumes and would have a significant ongoing Budget impact. Such an approach would also be inconsistent with the requirements of the *Australian Postal Corporation Act 1989 Act*, and with the Government's Government Business Enterprise (GBE) guidelines which require GBEs to operate and price efficiently and earn at least a commercial rate of return.

In addition, Government funding could provide an incentive for Australia Post to be less efficient. Australian Government financial support to fund Australia Post's losses in the letters business would represent a taxpayer subsidy to Australia Post's employees and its customers, the majority of which are businesses and government agencies.

Urgent revision of outdated regulatory requirements represents the most effective and timely response to Australia Post's immediate financial viability issues.

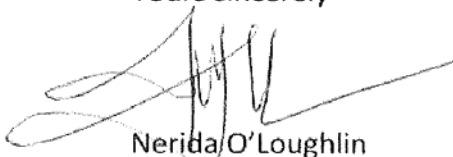
### **3. Future of Australia Post's CSO**

The RIS also examines the future of Australia Post's CSO. It notes that the important social and economic communications role that the letters service once provided is diminishing, with the internet/mobile-based services rapidly replacing letters as the principal form of communication. The CSO ensures access to affordable postal services throughout Australia, particularly for vulnerable Australians and regional communities. Despite the reduction in letter volumes, there is a continuing reliance on letters in some sectors of the community with Australia Post carrying 3.4 billion addressed letters in 2013-14.

There is a risk that the proposed regulatory changes will be insufficient to maintain Australia Post's viability and ability to provide the CSO into the future as letter volumes continue to decline. Should prices fall below costs as the letters market shrinks, Australia Post's financial position would continue to deteriorate, requiring the Australian Government to consider further reforms focussing on the future structure and role of Australia Post. Implicit in this would be a review of the appropriateness, nature, continued relevance and perhaps the funding mechanism of the CSO as consumers increasingly switch to digital technologies to meet their communications needs.

I submit the RIS to the Office of Best Practice Regulation for formal final assessment.

Yours sincerely



Nerida O'Loughlin  
A/g Secretary

20 April 2015