

# **3. Summary and Recommendations**

## **1. Introduction**

In formulating the principles of postal tariff policy two issues are of prime concern. These are (i) the basis for pricing of various postal services; (ii) an economic evaluation of the claim of the IPD on the general revenues of the government. In this chapter we present a summary of our recommendations and analysis of these issues and recommendations based on the results of the analysis. Additionally we comment on some aspects of the financing of the IPD.

## **2. Pricing of Individual Postal Services**

At the broadest level there are three possible approaches to the pricing of individual postal services. These are : (i) "political" rates, (ii) commercial rates, and (iii) economic rates. Postal pricing in India seems to have been based on an amalgam of all three approaches, but not in any rational manner. The principle behind the political rates appears to be that prices of postal services have an important social function and, therefore, social/political considerations prevail over others in their determination. Typically, then, the problem of costing postal services would not be of much relevance in their pricing.

Commercial rates tend to exploit, for profit, the position of the post office as a monopoly supplier of postal services. Correspondingly, costing is a relevant consideration although the objective of the postal department in this case is, explicitly,

to earn a positive return over cost and not necessarily maximising it.

Postal services being in the nature of a public utility constituting a basic infrastructure for development, its pricing purely on commercial principles might not maximise social welfare. At the same time, prices unrelated to costs or at least a clear accounting to costs often leads to waste and inefficient use of scarce resources. Also, pricing on political considerations alone without any regard for costs may confer unduly large benefits on sections who do not deserve it and place the burden on weaker sections. Hence the need for basing the prices of postal services on economic principles, whereby the services provided by post offices do not lead to waste and inefficiency and at the same time the objectives of social justice are also taken duly and explicitly into account.

In this report we purport to concentrate exclusively on economic rates. In designing these economic rates some well defined norms of social welfare are invoked. The theoretical basis for such norms are discussed at some length in Chapter 7 of this report.

We provide a set of four approaches to the economic pricing of postal services. These are :

- i. *First best/cross-subsidy-free prices with a balanced budget for the postal department.*

With this method prices of individual postal services reflect fully allocated costs. Correspondingly the budget of the postal department is exactly balanced.

The basic rationale behind this approach is that the pricing structure should be such that each constituent service of the IPD must earn at least as much as it would as a separate service or constituent of any smaller group of services. If this (potential) alternative is visualised as competitive supply, then it would follow that the postal department would be supplying its services in the most efficient manner.

ii. *Two-tier pricing with cross-subsidy-free prices and an overall subsidy--the eclectic approach.*

Cross-subsidy-free prices, although efficient, might involve "high" prices for several items. In the case of IPD a perusal of Table 5.6 of Chapter 5 will readily indicate this to be the case.

Such prices, it may be argued, conflict with some other objectives of the government, e.g., caring for the poor (redistribution of incomes) or widest dissemination of information through the use of postal services. If, for instance, it is felt that the full cost prices of items used in relatively large amounts by the less well-off sections of society are too high, there might be a case for subsidising some of these items.

The approach taken in this report to tackle this problem is the following: For purposes of internal accounting within the IPD, cross-subsidy-free prices are used. This ensures efficiency within the postal department itself. For purposes of fixing the consumer prices however the government is free to levy tax/subsidy on these first best accounting prices. That is to say, the equity objectives are taken care of by transfers from the general budget. This 'eclectic' approach then combines efficiency within the postal department with the redistributive objectives of the government. Under certain circumstances this approach has some desirable welfare properties.

iii. *Second best prices.*

If (competitive) efficiency is not the sole consideration, then there can be at least two reasons why prices of postal services can be different from cross-subsidy-free prices: (a) The IPD may not be a monopoly or a competitor in all markets and (b) the government may have specific redistributive objectives.

In such cases it might become necessary to compute second best prices for postal services. This computation involves a clear enunciation of government's welfare function that takes into account the governmental objectives like equity and resource

mobilisation. This welfare function is maximised with respect to postal prices and this maximisation is subject to an overall budgetary constraint of the government. Since this maximisation is subject to the budget constraint, the resulting postal prices are second best optimal. We would typically expect them to involve lower prices for distributionally significant items such as letter cards and post cards and higher prices for less significant items such as registered letters in comparison to first best prices. In Table 5.17 (Chapter 5) we provide detailed estimates of second best optimal prices on the assumption of certain weightage pattern for services based on considerations like distributive justice.

In Chapter 6 we recommend dual prices for certain postal services from the point of view of balanced regional development and regional income distribution. In particular, we recommend concessional prices for demands for postal services originating from less developed regions in the country. We believe that this dual pricing scheme is practicable and can be implemented without additional financial burden on IPD.

#### *iv. Cross-subsidisation with overall budgetary deficit*

This approach is currently being practised by IPD. In Table 5.10 of Chapter 5 we present estimates of cross-subsidisation of major services provided by the IPD. In Table 5.11 of Chapter 5 the corresponding budgetary deficits are reported.

This method does not have any welfare optimality properties unless it can be demonstrated that the existing subsidies and the budgetary deficit are derived from a specific welfare maximisation exercise, e.g., the second best approach outlined above. In any event, all pricing strategies that prescribe cross-subsidisation involve the risk that successful competitive services may eventually be provided by private agencies.

Our purpose in describing the four approaches to pricing is to clearly articulate the possibilities available to the IPD. For obvious reasons we single out first best and second best pricing

strategies for exhaustive discussion in this report. So far as the eclectic approach is concerned, taxes/subsidies on individual postal services have to be set as part of the overall budgetary policies of the government. In other words, taxes/subsidies on individual postal services have to be evaluated along with the taxes/subsidies on commodities in general. Since redistributive concerns form the *raison d'etre*, for a departure from first best pricing in the eclectic approach, a broad principle of such departure could be to subsidise those services that are used in disproportionately large measure by the poor and tax those that are used relatively more by the more affluent sections of society.

As we had remarked earlier, cross-subsidisation with a budgetary deficit for IPD has no claim to welfare optimality unless it can be demonstrated that this approach corresponds to, say, second best pricing. Hence we realise that first best or second best pricing rules are the bases that any sound pricing strategy must adopt. Correspondingly, in this study we undertake an exhaustive study of first and second best pricing rules.

Average price computations under these two regimes are reported in Table 5.6 (Chapter 5) for first best prices (for the years 1981-82 to 1985-86). There is some reason to believe that price schedules for some postal services must be such that marginal prices may differ from average prices. This may be because government may want to discriminate among categories of buyers by their quantum of purchases for redistributive reasons. Additionally, it could be argued that typically larger volume users display greater elasticity of demand than smaller volume users. Since larger volume users help the IPD to exploit economies of scale, it would only be fair to return to such users some of the savings they help attain. In Tables 6.18 to 6.21 (Chapter 6) we report marginal prices computed as per the declining block scheme that are consistent with the average prices reported in Chapter 5.

These calculations summarise our recommendations with respect to the pricing of individual services supplied by the IPD.

### 3. Deficits of the IPD

A virtue of economic pricing is that pricing policies and deficits have to be analysed jointly. In the eclectic approach, deficit that results must be justified because taxes/subsidies on individual postal services are evaluated along with taxes/subsidies in general. In the second best approach, revenues from postal services are evaluated against revenues from other sources, e.g., indirect taxes. Hence it is no longer necessary to think of the deficits of the IPD as the excess of expenditure over receipts.

However, in the case of the pricing policy that is actually practised, viz., cross-subsidisation with overall deficit, the deficit is essentially the residual. Further, in the case of the IPD, there is some inconsistency in the data because the sum of the deficits/surpluses on individual postal services does not add up to the overall deficit of the IPD. The estimates of deficit as reported in Table 5.11 of Chapter 5 are derived from the Appropriation Accounts. Our estimates of deficit are different from those of the IPD because our notion of cost is economic cost which must include cost on account of all factors of production, e.g., labour, capital and materials, whereas in the case of the IPD only accounting costs are considered.

In any event it is not possible to justify this deficit in terms of any welfare calculus unless it can be demonstrated that the pricing structure is derived from, say, a second best optimisation exercise. Our exercises suggest that the pricing practised by IPD does not follow any rational principle and is the outcome of *ad hoc* decisions made over the years without any attempt to take an overall look or rationalise the structure. As a result one notices an overall deficit subsidised by the general budget along with surpluses derived from services which *prima facie* are used mainly by the Department.

### 4. Financing of the IPD

In its 1968 Report to the Administrative Reforms Commission, the Working Group on Post and Telegraphs had emphasised that

the P & T Department should present its own budget to Parliament. It had further recommended that (the then) P & T department should be made accountable for its revenue and expenditure. The present practice in IPD seems to be that although this department does maintain separate accounts it can potentially draw upon the general revenues of the government at almost any time. Many observers have expressed the view that such latitude is inimical to financial accountability.

Short of making the IPD an independent corporation, it is possible to increase its financial accountability by making it possible for the IPD to draw, ordinarily, only from a revolving fund. The government can help set up the fund and all surpluses of the IPD can be credited to it. It is felt in some quarters that this practice might restrain IPD claims on the general exchequer.

The idea of a revolving fund merits attention from financial analysts and accountants. As economists we can say that creation of such a fund does not obviate the necessity of a sound and rational price policy. Year-to-year deficits will still have to be justified.

## **5. Revision of Tariffs by IPD**

The frequency with which IPD may revise its tariffs is an important issue. There is an argument that postal prices should not be changed very frequently. It is contended that stable postal prices help in lowering inflationary expectations. Further, since certain items of the post are used predominantly by the poorer sections of society, frequent hikes in postal rates may be regressive.

However, we find the counter-arguments more tenable. Postal tariffs should not remain out of line with postal costs for too long. This is particularly important in the case of the eclectic approach where taxes/subsidies on individual postal items have to be evaluated against taxes/subsidies on other items in the general budget of the government. Moreover, the social cost of

the deficits of the IPD have to be evaluated as part of the overall policies of the government. Furthermore, frequent revisions of tariffs of IPD need not mean that the tariff structure would become regressive. This is because it is always possible to subsidise items that are largely used by the poorer sections and tax those that are used by the richer sections of society.

We, therefore, recommend that IPD may revise its tariffs annually by following any one of these procedures:

- (a) Using the method described in Section 1 of Chapter 5 the estimation of full cost prices for postal services may be attempted by IPD every year, taking into account changes in the prices of labour, capital and material inputs. Adopting full cost prices as base prices, subsidies for some services and mark-ups for the other services may be fixed so that IPD balances its budget and realises its various social objectives. This results in the cross-subsidisation with balanced budget for IPD as described in detail in Section 2 of Chapter 5 and Section 4 of Chapter 6.
- (b) Alternatively, IPD may set the prices for its services by preparing and presenting an annual budget to Parliament as its sister department, Railways, does in India. The preparation and presentation of annual budget by IPD will provide it autonomy to fix prices for its services and also facilitate public scrutiny and debate over its policies. In this process, the budgetary deficits created by the pricing policies of IPD to achieve various social objectives will have prior approval of Parliament and the public. This procedure is akin to the eclectic approach described in Section 5 of Chapter 7 for the postal budget, like the budget of Railways, will be very much part of the annual budget of the Union Government.

## 6. Conclusions

In this chapter we have briefly commented on the approach to postal tariffs that is adopted in this report. We have also



commented briefly on IPD's deficits as well as on a suggestion for improving the financial accountability of IPD.

The plan of the rest of the report is as follows. In Chapter 4 we define an index of productivity of IPD and trace its development over the period 1950-51 to 1983-84. In Chapter 5 we compute average first best and second best (with balanced budget) prices for IPD for a few representative years. In Chapter 6 we present our estimates of marginal (declining block) prices under these two regimes. Chapter 7 details various approaches to public utility pricing and discusses the theoretical rationale for adopting the four pricing strategies detailed in the chapter.