

MAGLI, Martin; FINGER, Matthias; JAAG, Christian

**Regulatory Institutions and Governance Costs in
the Postal Sector:
The Case of Switzerland**

Chair Management of Network Industries - MIR
CDM Working Papers Series

June 2008 MIR-WORKINGPAPER-2008-005

Paper presented at the 2nd Global Postal Research and Education Network Conference, Lausanne 2008 and at the 2nd Biennial Conference of ECPR Standing Group on Regulatory Governance, Utrecht 2008

Keywords : Regulatory Governance, Postal Sector, Regulatory Institutions, New Institutional Economics

Abstract

Currently there is a strong trend toward sector-specific regulatory authorities across sectors and countries. However, liberalization has not led to a common European regulatory model. The circumstance that different old and new regulatory authorities exist in parallel not only raises agency problems, but also requires a horizontal coordination among the different authorities and their competences. The regulatory regimes differ in the degree to which regulatory authorities are upwardly accountable to governments, horizontally active alongside or related to courts and regulators, or downwardly responsible for operators and interest groups. Based on Williamson (1996, 2005) as well as on Spiller and Tommasi (2005) we try to develop conceptual foundations about the definition and identification of governance costs in regulatory regimes. Following our theoretical findings we explore the Swiss postal regulatory regime and its institutional framework. Our focus is on the identification of the institutional design and the drivers of governance costs in the specific setting of Switzerland.

Table of content

1.	Introduction.....	1
2.	Theoretical Foundations:	2
2.1	An Overview on Regulatory Governance.....	2
2.2	Conceptual Background: Institutions and Actors in Regulatory Regimes.....	3
2.2.1	New Institutional Economics	3
2.2.2	Organizational Behavior Theory	4
2.3	Preliminary Conclusion	5
3.	Costs of Governance in Regulatory Regimes.....	5
3.1	Perspectives on Regulatory Structures.....	5
3.2	Regulatory Authorities: Behavior	6
4.	Institutional Setting in the Swiss Postal Sector	7
4.1	Regulatory Framework in Switzerland	7
4.2	The Swiss Model: Pricing Products in Universal Services.....	9
4.3	Pricing Universal Service: The Formal Procedure and the Involved Actors	9
4.4	Conflicts and Institutional Challenges Concerning the Swiss Example	10
5.	Conclusion	12
6.	Limitations and Implications for Future Research:	12
	References	13
	Appendix	17

1. INTRODUCTION

Even though there is a strong trend toward independent sector specific regulatory authorities across sectors and countries, liberalization has not led to a general European regulatory model. Different countries exhibit different institutional endowments (in network industries in general and in the postal sector in particular), which in turn lead to different regulatory practices. The creation of new independent and sector-specific regulatory agencies gives rise to a potentially important agency problem: Regulators may well tend to act in their own interests and contrary to the intentions with which they were originally established. In such a dynamic context where regulatory authorities behave as self-interested social actors¹, regulators start to strategize vis-à-vis the other actors so as to increase their own discretionary power and become part of economic interaction they were supposed to govern.

Furthermore the circumstance that different old and new regulatory authorities exist in parallel not only raises potential vertical agency problems, because they are governed at different levels, but also requires a horizontal coordination among the different authorities. Coen (2005) observes that newly created independent authorities deal differently with different institutional arrangements in different countries. Through the lens of transaction cost economics as well as agency theory, different modes of regulation can be described as alternative modes of governance which are well suited for some objectives but purely suited for others. Regulatory intervention in general has two comprehensive objectives with respect to (1) market power and (2) public goods: the first objective is to stimulate the effects of competition where competition is inexistent or poor. Such monopolistic (or oligopolistic) structures are dominant in network industries or financial services and often linked to former (or still) state-owned companies. The second, almost complementary, objective is to enforce outcomes not appearing under conditions of full competition, e.g. by providing universal services (OECD 2005, p.31).²

Williamson (1998) points out that there exists no superior mode of organization and within the different frameworks transaction costs vary in their attributes as well as governance structures vary in their costs and the alignment of competences within the system. The variations of strategic behaviour and incentives across different actors play a significant role in terms of the evolution of regulatory institutions and governance costs (transaction costs) within a regulatory regime.

In this paper we explore the Swiss postal regulatory regime and its institutional framework (rules and actors). Our focus is on the identification of the institutional design and potential governance costs in the specific setting of Switzerland. Our main research questions are:

- What is the design of the Swiss postal regulatory regime ?
- How to identify and determine governance costs in a regulatory regime with multiple regulatory authorities?

The article shows how governance costs and institutions in regulatory regimes are affected by the involved authorities from a theoretical perspective in general and in the specific institutional setting of Switzerland in particular.

¹ Actors react differently to external threats, constraints and opportunities because they differ in their intrinsic perceptions and preferences but also because these are shaped by the specific institutional setting within which they interact (Scharpf 1997, p. 37). Crozier (1964) interprets such a behavior as “the active tendency of human agent to take advantage, in any circumstances, of all available means to further his own privileges” (p.194).

² The presented research project, discusses regulation in terms of regulated network industries in general and the postal sector in particular.

2. THEORETICAL FOUNDATIONS:

The Regulatory system's design consists of (1) the objectives of infrastructure regulation (its purposes and functions); and (2) the specific institutional framework for regulation (Stern and Holder 1999, p. 34). The first aspect is concerned with the theory of regulatory governance while the second aspect is concerned with the design of regulatory institutions.

2.1 An Overview on Regulatory Governance

In their seminal article on institutional foundations of regulatory commitment, Levy and Spiller (1994) emphasize that there are multiple regulatory regimes which are consistent with good performance. They define regulatory governance from an institutional perspective as "the mechanisms that societies use to constrain regulatory discretion and to resolve conflicts that arise in relation to these constraints." The main question concerning regulatory governance is how to design a regulatory framework that allows governments to maintain control over a regulated sector.

Majone (1996, p. 2) discusses traditional forms of regulation and control (regulatory governance structures) in Europe including public ownership, the assignment of regulatory functions to departments of governments under direct control of political executives, and various self-regulatory arrangements. These modes of regulation are gradually displaced because regulatory policies are nowadays rarely implemented by politicians themselves. Governments delegate regulatory competencies to specialized authorities. Independent sector-specific regulatory authorities are a relatively recent phenomenon and in just a decade they have become widespread in Europe (Braun/Gilardi 2006, S.10). But even though a strong trend toward independent regulatory authorities across sectors and countries was observed, liberalization has not led yet to a unified European regulatory model. One might argue, that the independent sector specific regulator represents the new regulatory model. Most of the new institutional arrangements do indeed have at their core an independent sector specific regulator, but there are still significant differences among countries. The comparison of different independent authorities shows that they rely on completely different institutional backgrounds and arrangements. Coen (2005) points out that newly created independent authorities learn to deal with different institutional arrangements in different countries. This implies that independent regulatory authorities exhibit different behaviours in different regulatory arrangements. He points out that regulators "differ in the degree to which they are upwardly accountable to governments, horizontally accountable to courts and regulators, or downwardly accountable to business (p. 394)".

Wilks and Bartle (2002) argue that the original decision to delegate and the design of agencies were primarily motivated by a need to reassure and to appear to act. The agencies were not expected to be extremely active in developing and implementing policies. However, the regulatory agencies have become more active than expected and have contributed to policies (p.148). Wilks and Bartle further state that "the consequences of creating agencies has been to populate the policy area with actors (agents) who have their own priorities, interpretations and influence (p. 148)". Spiller and Tommasi (2005) emphasize a shift away from investigating regulation as a pure government/firm game. The agency is by definition created as an entity to be independent from governmental, and consequently from political, influence. Spiller (1990) points out that regulators do not fully respond to governmental desires and raises the question: "Why does Congress delegate regulatory issues to agencies that are not fully aligned with it and what are the implications of delegation for regulatory commitment?" (Spiller/Tommasi 2005, p. 531).

An explanation according to the phenomenon of delegation is given by Majone (2001) as well as Thatcher and Stone Sweet (2003): Following their comments, the aim of delegating regulatory issues to agencies is to establish market and technical expertise, blame-shifting potential, and credible commitment to efficient market developments. However, creating an independent regulatory agency gives rise to a potentially important problem: agencies may act in their own interests and contrary to

the objectives and policies established for the original political intent (McCubbens, Noll, Weingast, 1989, p. 246).

Concerning the control of regulatory agencies Weingast and Moran (1983) develop the “Congressional Dominance” hypothesis which implies that independent agencies are not fully independent. The circumstance that agencies underlie permanent congressional oversight raises potential agency problems. Perfect oversight would require congressional instruments to be powerful enough to fully control the regulatory agency. Agency problems between government and regulatory agencies occur because regulators actions are intrinsically unobservable. Gilardi (2005) states that governments usually lack control mechanisms which enable them to have an effective and direct impact on the regulatory agency’s behavior. Hence the specialized independent and sector-specific agencies are, unlike ordinary bureaucracy, difficult to control.

2.2 Conceptual Background: Institutions and Actors in Regulatory Regimes

Willman et al. (2003, p.73) criticize the purely economic approach to regulation: the economic approach to the design of institutions tends to focus on outcome, rather than the analysis of the process. Therefore it does not adopt a dynamic perspective on institutional change. It is prescriptive rather than analytical, and it focuses on the properties of institutions rather than taking the regulatory relationship as a unit of analysis. Finally, it considers the firm as a single decision point which seeks return on investments whereas the analysis of regulatory activity within an organization is neglected.

Concerning the theory of regulatory economics, Laffont and Tirole (1993) criticize the fact that economic theory ignores incentive issues to a large extent, and the theory does not consider the standards of the newly developed principal-agent theory. They further argue that the simplified economic models, which ignored the presence of imperfect information, were unrealistic because they implied policy recommendations that require information which is not available to regulatory authorities in practice. Laffont and Tirole (2000) abandon the standard economic assumption which defines regulators as well-informed and benevolent actors whose mission is to perfect an imperfect market and to achieve the best results for society. They argue that regulators, like other economic actors, are self-interested: “They, like anybody, must be provided with incentives to become (economic and technological) experts, to think hard about specific regulatory issues and to shun putting their career concerns or the stakes of their favored interest groups or causes first (p.274)”.

2.2.1 New Institutional Economics

The analysis of institutions and the part they play in the governance of economic action is the central challenge addressed by new institutional economics (NIE).³ The theoretical framework of new institutional economics links different approaches to explain economic activities and economic behavior. The three main areas are “Transaction Cost Theory”, “Property Rights Theory” and “Agency Theory”. New institutional economics builds on, modifies, and extends neoclassical theory. It has developed as a movement within the social sciences, especially economics and political science which unites theoretical as well as empirical research and addresses the role of institutions in shaping “the different arrangements that support production and exchange, as well as how these arrangements act in turn to change the rule of the game (Ménard/ Shirley 2005, p.2)”. The aim of new economic institutionalism is to understand changes by understanding human incentives, intention, and beliefs, as well as the norms and rules they create to reach their goals. Taking an institutional perspective, the key elements of regulatory frameworks are institutions (in the form of rules) and actors. Ménard and

³ An overview on the current discussion in NIE and modes of organization is given by Ménard (2005).

Shirley (2005, p.1) define institutions as the written and unwritten norms, rules and constraints that humans devise to reduce uncertainty and control the environment. North (1994, 2005) denotes institutions as the rules of the game, not only the formal but also the informal norms and the characteristics of enforcement. The dominant actors in regulated network industries are governments, regulatory authorities, incumbent firms, new entrants and several interest groups. Behaviorists in political science argue that, in order to understand politics and explain political outcomes (such as regulatory policy) research should not only focus on the formal attributes of government institutions but also on the informal distribution of power, attitudes, and behavior among the actors (Thelen/Steinmo 1992, p.4). Williamson (2005, p.41), describes transaction cost economics as an effort to better understand sophisticated economic organization by alternatively linking *economics*, *law* and *organization theory*. Williamson (1996) summarizes that different modes of governance vary with the institutional environment on the one hand, and with the economic actors' attributes on the other hand (p. 223). Epstein and O'Halloran (1999) describe transaction costs economics as an approach for comparative institutional analysis where a given set of transactions may be characterized by its variety of costs; and different modes of governance might affect the level of these costs. In their perspective the task of the transaction cost approach is to predict how optimal governance structures change as the formation of transaction costs changes. In his article "Transaction Cost Economics: How it works; Where is it is Headed" Williamson (1998) then points out that there exists no superior mode of organization and within the different frameworks transaction costs vary in their attributes as well as governance structures vary in their costs and the alignment of competences within the system.

Considering regulated industries, the view with emphasis on transaction costs is related to the principal agent framework. It assumes that heterogeneous parties, politicians, bureaucrats and courts, will act with limited or asymmetric information in bargaining processes. The principal Agent theory is grounded on studies in information asymmetries. The construct of bounded rationality takes the disability of economic actors to obtain perfect information into account. There are three environmental conditions according to information problems: Adverse selection, moral hazard and hold up. All of them are underlying to a certain problem of coordination and motivation. *Adverse selection* bears the risk of principals of selecting the wrong contractual partner. *Moral hazard* contains the risk that a party does not enter into a contract in good faith (opportunistic behaviour). While *hold up* problems cause the purposely, asymmetrically distributed information by individuals to raise individual gains.

However, Thatcher and Stone Sweet (2002, p.2) notice that Principal Agent Theories remain an incomplete theory because they do not consider organizational and interorganizational dimensions within regulatory frameworks. Our aim is to develop a more dynamic perspective that considers organizational and actor-specific dimensions to explain how institutions evolve over time and actors try to shape their environment. Therefore the second conceptual pillar is organizational behavior theory.

2.2.2 Organizational Behavior Theory

Organizational behavior theory is interested in how and why the behavior of organizations changes over time. Concerning regulatory governance the theory implies that regulatory authorities will not simply stick to their original goal. Rather, they will displace their original goal or add new goals to the original one, especially if not actively monitored and supervised by the political authorities. Martimort (1999) suggests, that in a dynamic context, the regulator starts to strategize vis-à-vis all stakeholders so as to increase its own discretionary power. Crozier (1964) interprets such an opportunistic behavior as "the active tendency of human agent to take advantage, in any circumstances, of all available means to further his own privileges" (p.194). Bonardi et al. (2006) suggest that agency decisions can have important consequences for stakeholders (especially firms) and that agencies behave differently from elected political institutions. Regulators are generally appointed rather than elected. Therefore they do not face the election constraints that typically motivate elected politicians' behavior. Prior research highlights, that regulatory agencies' objective functions are multidimensional: regulators tend to maximize their budgets, enlarge the number of employees or enhance career prospects and political

reputations (Bonardi et al. 2006; Mueller 2003; Wheaterby 1971). Majone (1996) summarizes that the achievement of such objectives depends on the legitimacy that the regulator holds within the institutional framework. He defines the preservation and the enhancement of legitimacy as a meta-objective of regulators.

2.3 Preliminary Conclusion

Following the explanations we conclude that new institutional economics in general and transaction cost economics in combination with principal-agent and organizational behavior theory in particular provide a useful framework to explore regulatory governance structures or more precisely to analyze different institutional settings in regulatory regimes. Libecap (2005, p. 551) explains that the consideration of transaction costs supports the analysis of how sets of regulation take the form they do. New institutional economics facilitate the understanding of actual human as well as organizational behavior, institutions and resource outcomes. In order to explain the coherence between organizational theory and new institutional economics Williamson (1996) comes to the conclusion that “*the economics of governance needs to be informed both from the level of the institutional environment (where sociology has a lot to contribute) and the level of the individual (where psychology is implicated). The intertemporal process transformations that take place within the institutions of governance (with respect to which organization theory has a lot to say) are also pertinent (p. 245)*”.

3. COSTS OF GOVERNANCE IN REGULATORY REGIMES

Regulatory governance has a significant cost which is raised by the various actors within an institutional framework in unequal ways. This overall governance cost is in our view still largely underestimated or even ignored. Furthermore, it is also obvious from even simple empirical observation that the sector specific regulator is not a neutral actor promoting market perfection in a disinterested way. Our substantial challenge is the conceptualization and the construction of governance costs. Even though we will not come to final conclusion in this paper, we try to shape the conceptualization of governance costs and its drivers in regulatory regimes.

3.1 Perspectives on Regulatory Structures

From an institutional point of view, we define governance costs as the costs of running a regulatory framework. This includes the costs of coordination as well as costs of gathering information within a system. Regarding an organizational perspective, the costs of running a regulatory system are as well raised by the behavior of the individual actors vis-à-vis the other involved actors within a particular regulatory system. The key elements of regulatory frameworks are rules (institutions) and actors. Table 1 summarizes the two different dimensions of regulatory governance and the different sources of governance costs. The first rather institutional perspective stresses formal rules in terms of institutions in the regulatory setting. The second perspective is focusing on the actors and their behavior within the system. It is determined by the formal organization of an institutional actor as well as on the informal rules and its behavior vis-à-vis other actors. The design of rules defines what actors do or what they are not allowed to do. They shape the competences, the accountability, and the formal relationships between the actors within the regulatory framework.

Table 1: Dimensions of governance structures and sources of costs.

	Dimensions of Regulatory Governance Structures and Sources of Governance Costs		
Relevant Subject:	Institutions: The Institutional Structure	Actors: Organizational Behavior	
Analysis of :	Formal Rules	Formal Organization	Behavior and informal rules
Attributes :	<ul style="list-style-type: none"> • Regulatory competence • Advisory/Supervisory power • Coordination with other authorities • Coordination with courts • Reporting requirements • Funding sources • Legal remedies • Objectives of regulatory policy 	<ul style="list-style-type: none"> • Budget • Staff size • Internal organization • Legal personality 	<ul style="list-style-type: none"> • Incentives and goals • Strategy • Information exchange • Staffing policy • Disclosure of data • Political attitudes • Informal coordination with actors

3.2 Regulatory Authorities: Behavior

Before we start the analysis of institutions respectively formal rules, we line out the assumptions behind the perspective of organizational behavior. Analyzing the state of research in the field of regulatory governance it is generally accepted that regulatory agencies cause principal agent problems.⁴ However, the circumstance that different old and new regulatory authorities exist in parallel not only raises potential agency problems, because they fall under governmental oversight and monitor the other economic players, but also requires a horizontal coordination among the different authorities and their competences. In other words, a sector specific regulator relates to and defines itself in relationship to its surrounding actors (such as the firms that are to be regulated, consumer protection associations, the government, the administration, the competition regulator, the parliament, as well as the other regulators who do similar things in other countries) by way of a complex system of formal and informal rules, which constitute its external incentive structure. Figure 1 illustrates the context within which regulatory authorities behave as self-interested social actors and start to strategize vis-à-vis the other actors so as to increase their own discretionary power. Seeking to increase their power, they might rely on several instruments which are actually partly (but not completely) described by new institutional economics and related to informational problems. The emergence of several forms of opportunistic behavior and asymmetric information becomes intuitively comprehensible. We assume that the implications of transaction costs and agency theory on regulation theory and practice are particularly relevant, but remain - save for a few exceptions mentioned in the literature review - widely unexplored.

Therefore we formulate the proposition that the independent regulatory agency is a discrete actor which not only acts benevolently, but also pursues its own interests. Hence the regulatory agency does not stand above the sector, but acts as a social actor whose behavior in turn affects the institutional environment and the regulatory regime's design.

⁴ See Section 2.

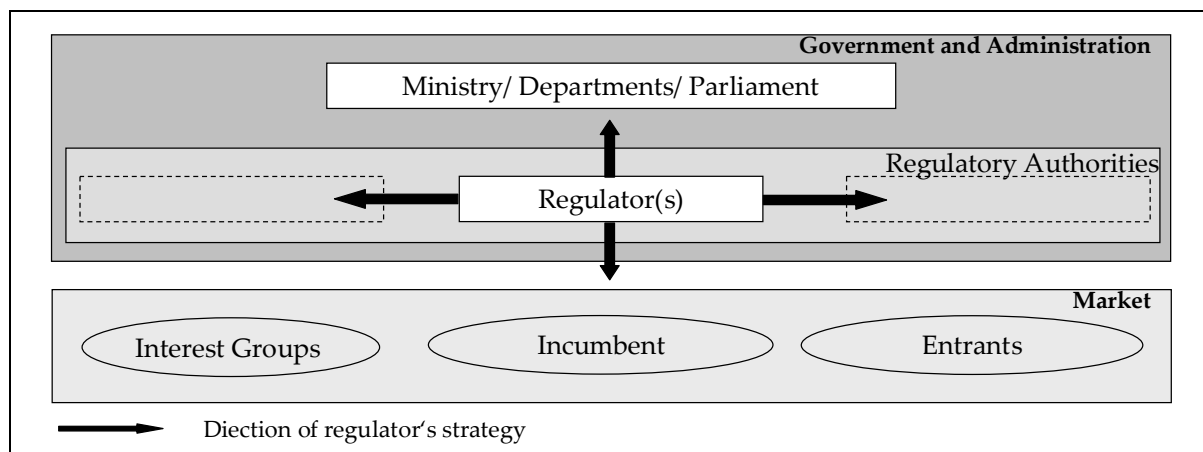


Figure 1: The regulatory authority as a discrete actor within the regulatory regime.

Describing the regulatory agencies as self interested actors implies that their behavior affect governance costs within the regulatory regime. Such a finding, derived from a combination of new institutional economics and organizational behavior theory, diverges from older standard regulatory economics, which considers regulators to be totally neutral (i.e., not self-interested) whose aim is to perfect an inherently imperfect market.⁵ It is fair to say that regulatory authorities will seek to increase their discretionary power by using all instruments at their disposal, such as uncertainty vis-à-vis the operators they regulate, goal displacement, or goal multiplication. They will also try to increase their discretionary power by trying to shape the rules under which they operate. This is made even easier if regulators simultaneously have policy advice functions, as it is the case in the in Swiss postal and in other sectors.

4. INSTITUTIONAL SETTING IN THE SWISS POSTAL SECTOR

The example of postal market regulation in Switzerland is chosen because it is particularly interesting institutional framework from a governance perspective: three different regulatory authorities are divided into two cross-sectoral regulators and a sector specific postal regulation authority, reporting to different ministries.

4.1 Regulatory Framework in Switzerland

The responsible ministry for the postal sector is the Federal Department for Environment, Transport, Energy and Communication (DETEC). Other involved ministries are the Department of Finance (FDF) and the Department of Economic Affairs (FDEA). As the State is the formal owner of the incumbent postal operator Swiss Post, the Federal Council, respectively the FDF is involved with the financial control of the incumbent and responsible for the appropriation of its profits.

The central regulatory authority in the postal sector is the postal services regulation authority (PostReg). Other participating actors are the Competition Commission (ComCo) with its secretariat and the price supervisor which are both functionally independent but organizationally accountable to the FDEA.

⁵ Cf. Laffont/ Tirole 1993, 2000.

PostReg is functionally independent but attached to the DETEC. As an independent regulatory authority PostReg monitors the Swiss postal market and ensures the provision of universal services, in terms of high quality and at affordable prices. The authority deals with complaints by the public relating to universal services, and ensures a fair and functioning competition in the opening postal market. Other responsibilities are the drafting of Federal Council and DETEC decisions (policy advice) and representing Switzerland in international organizations.

The Competition Commission is a group of 11-15 experts from different disciplines in charge of competition regulation in the classical sense (ex-post regulatory intervention in anti-trust and abuse of dominant position matters). The main tasks are the elimination of harmful cartels, monitoring dominant or monopolistic companies for signs of anti-competitive behavior, enforcing merger control legislation and preventing the imposition of restraints of competition by the state. The Commission is supported by a substantial full-time secretariat. It examines the suspected cartels and prepares the decisions for the ComCo.

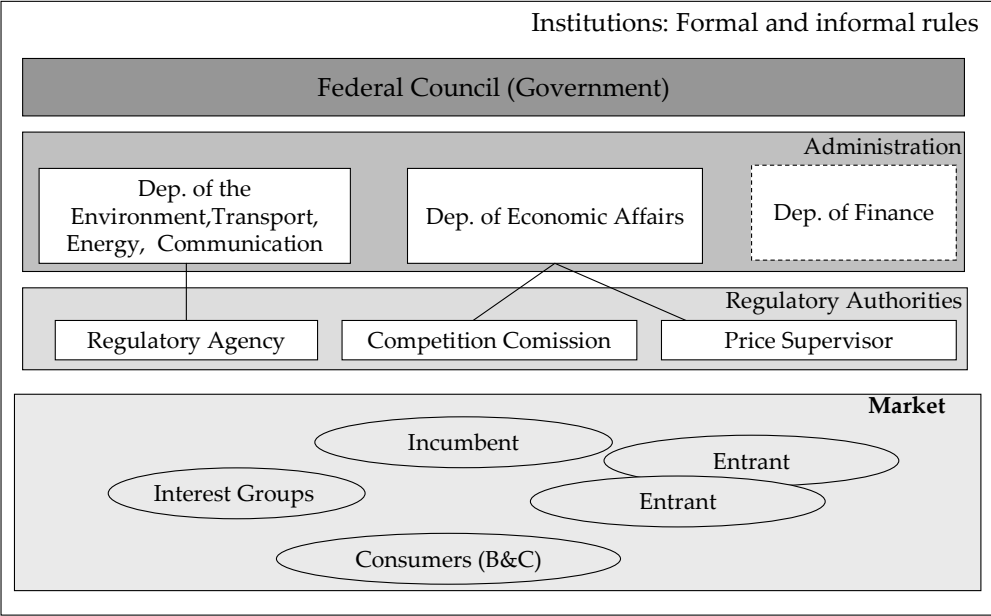


Figure 2: the institutional setting in Switzerland.

As mentioned above Switzerland knows the function of the so-called price supervisor, who has the power to sanction prices in the public sector as well as among firms with significant market power in an ex-ante manner. For example the prices in the reserved postal services (2007: addressed domestic letters up to 100g) are set by the DETEC on recommendation of the price supervisor and PostReg.

The incumbent operator Swiss Post is set up as an autonomous public corporation, wholly owned by the Swiss Confederation. It operates within the institutional limits laid down by the federal legislation. The Government not only determines the scope of postal products and services but also defines the strategic objectives of Swiss Post every four years.

The institutional framework respectively the formal rules in the Swiss postal sector are determined by the postal act of 1997 and its modification decree of 2004 and the federal ordinance 2004. Swiss Post’s organization is defined by the act on postal organization. Following the details mentioned above, there exists a substantial problem according to property rights, legislation and regulatory governance structures: The government is still the owner of the incumbent operator in the postal sector but also does not clearly distinguish between regulation of the sector and principal-agent type intervention in its own enterprise.

4.2 The Swiss Model: Pricing Products in Universal Services

Different regulators pursue different objectives and appraise different issues when they assess prices of universal postal services. Even though the addressed stakeholders are often the same, interests concerning prices are not necessarily the same. In this section we show how different regulators, parts of federal administration and the federal council are in charge of pricing and assess postal universal services in the reserved and in the liberalized (nonreserved) area.

The reserved area contains addressed domestic and inbound letters up to a weight of 100 g. Nonreserved universal services are addressed letters (domestic and inbound) heavier than 100 g, parcels up to 20 kilo and all outbound letters.

4.3 Pricing Universal Service: The Formal Procedure and the Involved Actors

The formal procedure of price setting is institutionally regulated in the postal act. Thus the postal operator sets the price in the nonreserved areas based on economic principles. And The Price Supervisor assesses if prices are incorrect due to abuse of market power and predatory pricing.

Prices in the reserved area underlie the authorization of DETEC. The sector specific regulator PostReg has no formal power to decree but gives recommendations and prepares DETEC's final decision. PostReg is interested in maintaining or even improving service quality at affordable prices for private and business consumers. PostReg's most important appraisal issues in the regulatory pricing process are Swiss post's operating costs, the quality of services (end to end delivery times, and customer satisfaction) and international price comparisons. The price supervisor, whose ultimate ambition is to establish fair prices for private consumers, has no formal power to decree in price setting in the reserved area, but he is involved in the price assessment proceedings with an advisory function. He - like PostReg - gives recommendations concerning the price level to the DETEC. The Supervisor's most important appraisal issue concerning the prices of public services in the reserved area is the adequacy of Swiss post's profits. Once he considers that the profits are beyond a certain adequate level, he will argue that postal services are overpriced. The competition commission gets involved in an ex post manner in case of predatory pricing of operators. But since both - PostReg and Mr. Price - are not legitimated to change and fix prices, one might ask which instruments are used to enforce their recommendation vis-à-vis the other involved actors? The media: They are not directly involved in the process of price setting, but they play a particularly important role in this institutional game. Regulators instrumentalize the media and their activity reports to make themselves heard. Therefore they are used as an endogenous instrument by the regulators.

Table 2: Pricing products in universal services - different actors have different backgrounds.

	Objective	Appraisal Issues	Institutional Background	Competences & Instruments
PostReg	<ul style="list-style-type: none"> • High quality of service at affordable prices • Prohibition of cross-subsidization • Enabling competition 	<ul style="list-style-type: none"> • Operating costs • Service quality • Int. price comparison 	<ul style="list-style-type: none"> • Postal ordinance • Postal act • Postal organization act <p>→ attached to DETEC → ultimate authority: DETEC</p>	<ul style="list-style-type: none"> • No formal power to decree • Recommendation to gov. • Media • Reports
Price Supervisor	<ul style="list-style-type: none"> • "Fair Prices" for private consumers • Prohibition of price abuse 	<ul style="list-style-type: none"> • Development of costs • Price history • Consumer requests • Appropriate profit of operator 	<ul style="list-style-type: none"> • Federal act on price supervision <p>→ attached to FDEA → ultimate authority: Federal court</p>	<ul style="list-style-type: none"> • Formal power to decree: abuse of market power • recommendation to the gov. in reserved area • Media
Federal Council	<ul style="list-style-type: none"> • Sustainable provision of public service • Consistency of regulators objectives • Allocation of profits 	<ul style="list-style-type: none"> • Service quality • Price • Incumbent's profit • Sourcing of USO 	<ul style="list-style-type: none"> • Postal act • Postal ordinance • Postal organization act 	<ul style="list-style-type: none"> • Defines strategic goals of Swiss post • Final decision on allocation of profits

Yet another institutional actor that is not fully involved but is non the less interested in the pricing procedures is the federal council. The objective concerning the public service is the sustainable provision of area-wide postal universal services with high quality. A second objective is the coordination of the different regulatory authorities, which are organizationally attached to different departments. The third task of the federal council is the definition of Swiss Post's strategic objectives and the allocation of its profits. The decision on the allocation of profits also includes the cash-flow from Swiss post to the federal treasury. The first payout from Swiss post to the federal treasury is due to Swiss post's profits in 2007 (300 Mio CHF). Since there is a cash flow from Swiss post to the government, the price Supervisor argues, that these 300 Mio. are not an appropriate profit and could be redistributed to private consumers. Table 2 exemplifies by means of PostReg, the price supervisor and the federal council how actors differ in their objectives, the appraisal issues, the institutional background, and competences in pricing products of universal services.⁶

4.4 Conflicts and Institutional Challenges Concerning the Swiss Example

The comparison of the different actors and their background shows, that the Swiss postal regulatory arrangement bears some institutional as well as behavioral conflicts:

A first conflict is due to the involvement of two (or even three in the nonreserved area) regulators in pricing procedures: concerning the pricing of universal services in the reserved area, they have no formal power to decree. The competences of regulators are overlapping and not clearly distinguished.

⁶ The full overview on all regulators, the administration and the federal council is in the appendix.

Even though the media are not directly involved in the process of setting prices, they play a particularly important role in this institutional game. They are used as an endogenous instrument by the regulators. Since PostReg and the Price Supervisor have no formal power of decision and are just allowed to make recommendations, they instrumentalize the media and their activity reports to proclaim their importance and to strategize vis-à-vis the other involved actors. The Price Supervisor is even institutionally obliged to inform the public about his activities.

A third conflict arises because both, the federal council and the price supervisor are interested in the incumbent’s profit. The Price supervisor assesses if the profit is appropriate. In his perspective high profits imply too high prices and earnings could be redistributed to the consumers. The federal council defines the strategic objectives of Swiss Post and is interested in the cash flow from Swiss Post to the federal treasury. In 2008 these are 300 million Swiss francs.

Conflicts one and two have a rather behavioral background with its origin in the institutional setting. The third conflict is purely institutional. Even though this is one particular example, it shows that there are conflicts concerning the competences of involved regulators, the strategic instruments they use, and the design of the institutional framework.

An institutional challenge related to the institutional design in the Swiss postal sector is the current postal law reform and the future design of the regulatory framework: The Federal Council has decided to revise the federal postal act and the act on postal organization in order to liberalize and enforce competition in the postal sector. The postal act defines the institutions - the formal rules - of the game. And the Postal organization act defines the formal organization, conditions, and objectives of one single actor (Swiss Post).

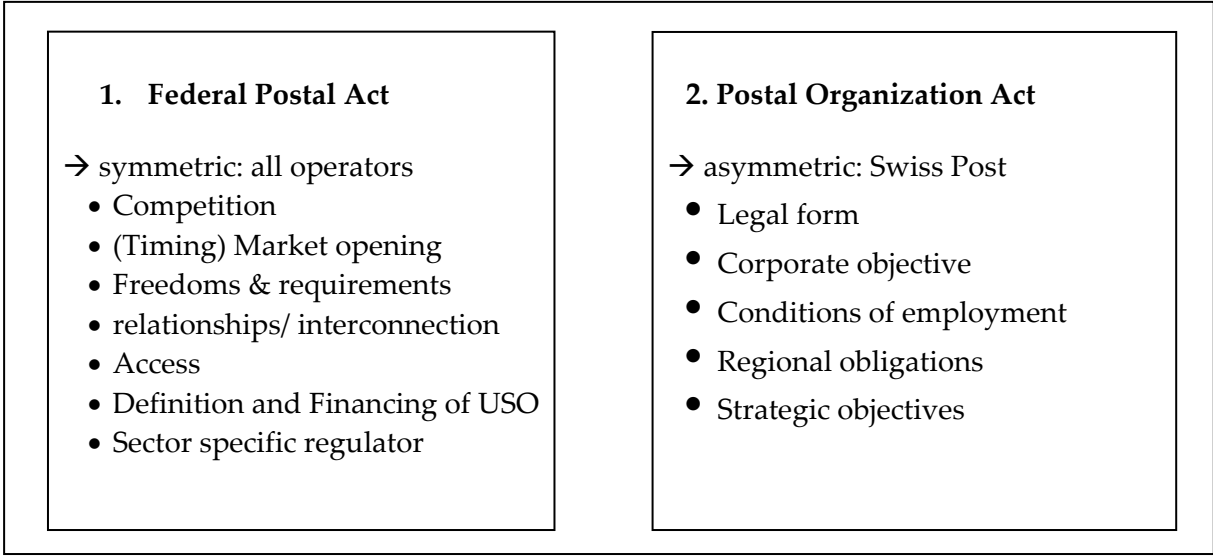


Figure 3: Asymmetries in the proposed postal law reform.

The proposal of the federal postal act is symmetric because it contains rules for all operators. The draft involves e.g. the symmetric regulation of competition and access. The federal act on postal organization is purely asymmetric and regulates just the incumbent operator and determines the legal form, conditions of employment and even strategic objectives of the incumbent. New market entrants will not be affected by these asymmetric obligations. Such an institutional framework will bear new institutional conflicts within the regulatory system, because some rules are addressed to all operators and others are only directed to the incumbent operator.

5. CONCLUSION

In this paper we address the concept of governance costs in regulatory arrangements. We assume that regulatory governance has a significant cost which we define as governance costs of a regulatory system. These governance costs are inherently present in regulatory arrangements and influenced by the various actors within a regulatory framework in unequal ways. We are focusing in particular on the role of the regulators and their relationships (among each other and to their principals in the federal administration and the government).

By analyzing the institutional setting in the Swiss postal sector and the process of pricing products of universal services, we identify several institutional conflicts and challenges.

1. The Swiss regulatory arrangement in the postal sector is particularly complex in terms of the division of powers because three different regulatory authorities are divided into two cross-sectoral regulators and a sector specific postal regulation authority, reporting to different ministries. The competences of the regulators are overlapping and not well-defined.
2. We observe some conflicts concerning the (1) competences of involved regulators, (2) strategic instruments, and (3) the institutional framework. The conflicts have their origin in behavioral features as well as in institutional circumstances.

One might ask how conflicts like the ones mentioned above are related to governance costs. We argue that the identification of the conflicts among actors in regulatory regime could be a solution to track sources of governance costs and to gain insights on how actors strategize vis-à-vis others. We assume that these costs are not easy to quantify. Considering our proposition - regulatory agencies are self interested actors and their behavior affects governance costs - we argue that the definition of governance costs goes beyond existing theories, such as transaction costs and agency theory, and it should involve aspects of organizational behavior.

So far we are able to identify two different dimensions that contribute to the construct of governance costs: the first dimension is rather institutional and is related to the formal rules and the institutional structure of the regulated sector. Concerning the regulators it includes issues like the formal competences and the objectives of regulatory policy. The second perspective is much more actor-centered and related to organizational behavior theory: it implies that governance costs are affected by informal rules and the strategic behavior of regulators which have their own objectives and political attitudes.

6. LIMITATIONS AND IMPLICATIONS FOR FUTURE RESEARCH

The main limitation in the present article is that we are not yet able to provide a distinct definition of governance costs in regulatory regimes. Therefore a challenge for future research is to come up with a clearly defined conceptualization of governance costs.

In order to clarify how future research can contribute to the conceptualization of governance costs in regulatory regimes in combination with the role of regulators we formulate the following questions:

- What are the objectives of regulators?
- What are the strategies of regulators?
- What are the consequences for the evolution of regulatory arrangements and governance costs?

An unsolved problem concerning behavioral aspects is the identification and conceptualization of informal attributes like e.g. strategies, objectives and informal relationships of involved actors.

The contribution of this kind of research will be to better integrate regulatory authorities in the institutional framework of regulation, the understanding of their behavior, and finally to explain how agencies' behavior affects the regulatory institutions and governance costs within a regulatory framework.

REFERENCES

- [1] BENHAM, L. (2005): "Licit and Illicit Responses to Regulation," in *Handbook of New Institutional Economics*, ed. by C. Ménard, Shirley, M.M. Berlin et al: Springer, 591-610.
- [2] BONARDI, J.-P., G. L. F. HOLBURN, and R. G. VANDEN BERGH (2006): "Nonmarket Strategy Performance: Evidence from U.S. Electric Utilities," *Academy of Management Journal*, 49, 1209-1228.
- [3] BRAUN, D., and F. GILARDI (2006): "Delegation in Contemporary Democracies," London: Routledge.
- [4] COEN, D. (2005): "Business-Regulatory Relations: Learning to Play Regulatory Games in European Utility Markets," *Governance: An international Journal of Policy, Administration and Institutions*., 18, 375-398.
- [5] CROZIER, M. (1964): *The Bureaucratic Phenomenon*. Chicago: University of Chicago Press.
- [6] EPSTEIN, D., and S. O'HALLORAN (1999): *Delegating Powers: A Transaction Cost Politics Approach to Policy Making under Separate Powers*. Cambridge: Cambridge University Press.
- [7] GILARDI, F. (2005): "The Formal Independence of Regulators: A Comparison of 17 Countries and 7 Sectors," *Swiss Political Science Review*, 11, 139-167.
- [8] GRONEWEGEN, J. P. M., and R. W. KÜNNEKE (2005): "Process and Outcomes of the Infrastructure Reform: An Evolutionary Perspective," in *Institutional Reform Regulation and Privatization: Process and Outcomes in Infrastructure Industries*, ed. by R. W. Künneke, A. F. Correlje, and J. P. M. Gronewegen. Massachusetts: Edward Elgar Publishing, 1-36.
- [9] LAFFONT, J. J., and J. TIROLE (1993): *A Theory of Incentives in Procurement and Regulation*. Cambridge MA: MIT Press.
- [10] LAFFONT, J. J., and J. TIROLE (2000): *Competition in Telecommunications*. Massachusetts: MIT Press.
- [11] LEVY, B., and P. T. SPILLER (1994): "The Institutional Foundations of Regulatory Commitment: A Comparative Analysis of Telecommunications Regulation," *Journal of Law, Economics, & Organization*, 10, 201-246.
- [12] LIBECAP, G., D. (2005): "State Regulation of Open-Access, Common-Pool Resources," in *Handbook of New Institutional Economics*, ed. by C. Ménard, and M. M. Shirley. Dordrecht et al.: Springer, 545-572.

- [13] LUÌS-MANSO, P., and C. FELISBERTO (2006): "Economic Regulation in the Network Industries," MIR-Report-2006-10, Lausanne: EPFL.
- [14] MAJONE, G. (1996): *Regulating Europe*. London: Routledge.
- [15] — (2001): "Nonmajoritarian Institutions and the Limits of Democratic Governance: A Political Transaction-Cost Approach," *Journal of Institutional and Theoretical Economics*, 157, 57-78.
- [16] MARTIMORT, D. (1999): "The Life Cycle of Regulatory Agencies: Dynamic Capture and Transaction Costs," *Review of Economic Studies*, 66, 929-947.
- [17] MCCUBBINS, M. D., R. G. NOLL, and B. R. WEINGAST (1989): "Structure and Process, Politics and Policy: Administrative Arrangements and the Political Control of Agencies," *Virginia Law Review*, 75, 431-482.
- [18] MÉNARD, C. (2005): "A New Institutional Approach to Organization," in *Handbook of New Institutional Economics*, ed. by C. Ménard, Shirley, M.M. Dordrecht et al.: Springer.
- [19] MÉNARD, C., and M. M. SHIRLEY (2005): "Introduction," in *Handbook of New Institutional Economics*, ed. by C. Ménard, and M. M. Shirley. Dordrecht et al.: Springer, 1-18.
- [20] MUELLER, D. C. (2003): *Public Choice III*. Cambridge: Cambridge University Press.
- [21] NORTH, D. C. (1994): "Economic Performance through Time," *The American Economic Review*, 84, 359-368.
- [22] NORTH, D. C. (2005): "Institutions and the Performance of Economies over Time," in *Handbook of New Institutional Economics*, ed. by C. Ménard, and M. M. Shirley. Dordrecht et al.: Springer, 21-30.
- [23] OECD, (2005): "Designing Independent and Accountable Regulatory Authorities for High Quality Regulation," London: OECD.
- [24] SCHARPF, F. W. (1997): *Games Real Actors Play: Actor-Centered Institutionalism in Policy Research*. Boulder: Westview Press.
- [25] SPILLER, P. T. (1990): "Politicians, Interest Groups, and Regulators: A Multiple-Principals Agency Theory of Regulation, or "Let Them Be Bribed"," *Journal of Law and Economics*, 33, 65-101.
- [26] SPILLER, P. T., and M. TOMMASI (2005): "The Institutions of Regulation: An Application to Public Utilities," in *Handbook of New Institutional Economics*, ed. by C. Ménard, and M. M. Shirley. Dordrecht et al.: Springer, 515-543.
- [27] STERN, J., and S. HOLDER (1999): "Regulatory Governance: Criteria for Assessing the Performance of Regulatory Systems: An Application to Infrastructure Industries in the Developing Countries of Asia," *Utilities Policy*, 8, 33-50.

- [28] THATCHER, M., and A. STONE SWEET (2003): *The Politics of Delegation*. London: Pinter.
- [29] THELEN, K., and S. STEINMO (1992): "Historical Institutionalism in Comparative Politics," in *Historical Institutionalism in Comparative Politics: State, Society and Economy*, ed. by K. Thelen, and S. Steinmo. New York: Cambridge University Press.
- [30] WAETHERBY, J. L. (1971): "A Note on Administrative Behavior and Public Choice," *Public Choice*, 107-110.
- [31] WEINGAST, B. R., and M. J. MORAN (1983): "Bureaucratic Discretion or Congressional Control? Regulatory Policymaking by the Federal Trade Commission," *The Journal of Political Economy*, 91, 765-800.
- [32] WILKS, S., and I. BARTLE (2002): "The Unanticipated Consequences of Creating Independent Competition Agencies," *West European Politics*, 25, 148 - 172.
- [33] WILLIAMSON, O. E. (1996): *The Mechanisms of Governance*. New York: Oxford University Press.
- [34] — (1998): "Transaction Cost Economics: How It Works; Where It Is Headed," *De Economist*, 146, 23-58.
- [35] — (2005): "Transaction Cost Economics," in *Handbook of New Institutional Economics*, ed. by C. Ménard, and M. M. Shirley. Dordrecht et al.: Springer, 41-65.
- [36] WILLMAN, P., D. COEN, D. CURRIE, and M. SENER (2003): "The Evolution of Regulatory Relationships; Regulatory Institutions and Firm Behaviour in Privatized Industries," *Industrial and Corporate Change*, 12, 69-89.

APPENDIX

Actors Objectives and Institutional Background

Authority		Objective	Appraisal Issues	Institutional Background	Instruments/ Competences	Stakeholder
Regulators	Sector Specific regulatory Authority (PostReg)	<p>High quality of service at affordable prices</p> <p>High quality of service at affordable prices</p> <p>Prohibition of cross-subsidization</p> <p>Enabling competition</p>	<ul style="list-style-type: none"> • Operating costs • Service quality • Int. price comparison 	<ul style="list-style-type: none"> • Postal act • Postal ordinance • Postal organization act 	<ul style="list-style-type: none"> • No formal power to decree (except in case of cross subsidization) • Recommendation to gov. • Media • Reports 	<ul style="list-style-type: none"> • Incumbent • Government • New entrants • Private and business consumers
	Competition Commission (ComCo)	<p>Workable competition</p>	<ul style="list-style-type: none"> • Market structure • Price 	<ul style="list-style-type: none"> • Federal act on cartels (Kartellgesetz) 	<ul style="list-style-type: none"> • Ex post regulation in case of predatory pricing 	<ul style="list-style-type: none"> • Private and business consumers • Operators

	Price Supervisor	<p>"Fair Prices" for private consumers</p> <p>Prohibition of price abuse</p>	<ul style="list-style-type: none"> • Development of costs • Consumer requests • Appropriate profit of operator • 	<ul style="list-style-type: none"> • Federal act on price supervision (Preisüberwachungs-gesetz) 	<ul style="list-style-type: none"> • Formal power to decree in case of abuse of market power • recommendation to the gov. in reserved area • Media 	<ul style="list-style-type: none"> • Private consumers
Admin	Dep. Of Environment, Transportation, Energy and Communication (DETEC)	<p>Sustainable provision of public service and maintaining its quality</p>	<ul style="list-style-type: none"> • Service quality • Price 	<ul style="list-style-type: none"> • Postal act • Postal ordinance • Postal organization act 	<ul style="list-style-type: none"> • Reserved area: Final decision based on postal act 	<ul style="list-style-type: none"> • Government • Public • Operators • Consumers
Government	Federal Council	<p>Sustainable provision of public service and maintaining its Quality</p> <p>Consistency of Regulators objectives</p> <p>Allocation of Profits</p>	<ul style="list-style-type: none"> • Service Quality • Price • Profit • Funding of USO 	<ul style="list-style-type: none"> • Postal Act • Postal Ordinance • Postal organization Act 	<ul style="list-style-type: none"> • Defines strategic goals of Swiss Pos • Final decision on allocation of profits 	<ul style="list-style-type: none"> • Public • Operators • Consumers • Ministries