

## **2. A Critique of Current Practices for Fixing Postal Tariffs in India**

### **1. Introduction**

In this chapter we try to highlight some of the weaknesses of the current practices for fixing postal tariffs in India. Such weaknesses may be broadly classified under five headings:

- (i) Problems of setting postal rates
- (ii) Problems of costing
- (iii) Problems of evaluating and justifying postal deficits
- (iv) Problems of capacity expansion
- (v) Problems with data

### **2. Problems of Setting Postal Rates**

The pricing strategy followed by IPD can be described as one involving cross-subsidisation and an overall budgetary deficit. We must first point out that the extent of cross-subsidisation actually involved is different from the IPD's measure of cross-subsidisation for the following reasons:

- (a) The IPD follows, in our view, an inappropriate method of allocating joint costs and
- (b) there is a difference between the economic cost and the cost adopted by IPD.

The principles followed by the postal departments in the

advanced countries to fix the postal tariffs cannot be replicated unconditionally in a developing country like India. Full cost prices with the balanced budget that are mostly adopted by the developed countries may not be appropriate for India since the postal services are the only means of communication available to poor people separated by long distances geographically. Therefore, social objectives like the rapid dissemination of information and the income distribution in the country can also be the basis for fixing the postal tariffs in India apart from the cost effectiveness. In this context, the pricing schemes involving either cross-subsidisation with the balanced budget for IPD or price subsidies to certain postal services with the budgetary deficits of IPD financed from the general revenue become relevant options for fixing the postal tariffs in India. The current practice of financing the deficits of IPD from the general revenues of the government may be legitimised, if the deficits are shown to be the result of price subsidies to meet the social objectives. This may be achieved if the annual budget of IPD is prepared and presented to Parliament as the railway budget is presented.

The current method of pricing followed by IPD (cross-subsidisation with budgetary deficits) is arbitrary because subsidies for certain services and mark-ups for the other services are fixed without careful economic evaluation. The present report puts forward four pricing strategies that could be followed and discusses their welfare properties.

### 3. Problems of Costing

An additional problem is the evaluation of costs. Since the IPD is a multi-product firm a significant portion of the costs are joint. Broadly speaking, the IPD distinguishes three categories of costs, viz., (i) directly attributable costs, (ii) indirectly attributable costs and, (iii) joint or non-attributable costs. The IPD allocates joint costs by the criterion of relative volume. But, as argued in Chapter 7, this method is arbitrary and does not yield efficient cost-based prices for the postal services. The literature on the

problem of public utility pricing suggests that it is better to allocate joint costs by the method of attributable cost. Indeed, this is the principle adopted in this report. As argued in Chapter 7, this method ensures efficient cost-based prices for certain types of cost functions. The key to the implementation of this method is the proper identification and measurement of attributable costs for various postal services.

One can find fault with the IPD's treatment of cost of capital as well as its treatment of depreciation. In this report we have tried to circumvent these difficulties in a manner that is consistent with sound empirical practice. The methodology adopted for costing is made explicit in this report and it is to be hoped that IPD would, broadly, follow the same approach.

#### 4. Problems of Deficit

As has been discussed, the pricing and costing practices followed by IPD are such that it is hard to justify the deficit in welfare theoretic terms. The deficits of the IPD have to be evaluated along with surplus/deficits of other government departments if we are to ensure the best use of public funds.

However, although an exercise involving the evaluation of the overall budgetary policies of the government is outside the scope of the present report, we must ensure that deficits of the IPD are the outcome of efficient costing methods and a pricing strategy that has a sound rationale in welfare theoretic terms.

As argued above, this is difficult to ensure with the essentially *ad hoc* pricing and costing practices adopted by IPD. On the operational side, since it has been possible for IPD to obtain funds at almost any time, it could be the case that IPD deficits have become harder to control in addition to being impossible to rationalise.

With the approaches followed in this report, no such arbitrariness in the treatment of deficits is possible.

## 5. Problems of Capacity Expansion

The supplies of various services by IPD are demand constrained. The data on output and cost of IPD during the period 1950-51 to 1982-83 show that IPD has planned its expansion in disregard of the demand for its services. The increased expansion of capacity coupled with the economies of scale of joint production has contributed to the presence of excess capacity in the IPD. Therefore, matching of capacity expansion with the growth of demand for its services should be an important consideration for the planned development of IPD in the future.

## 6. Problems with Data

The data presented by IPD leave much to be desired. For instance, if one examines the traffic demand figures one realises that for unregistered traffic the demand is highly exaggerated. Moreover, different statements prepared by IPD (e.g., Annual Reports and Statistical Digests of IPD) give widely divergent estimates of traffic demand for the same year.

The IPD aims at setting prices to effect some redistribution of income in society. However, whether this has happened, or indeed, is possible can be discovered only after a thorough investigation of the demand for postal items by different income categories. But the data for such an investigation are simply non-existent. These data can be collected by IPD on an annual basis for a representative sample of households in the Indian economy. The IPD should make all efforts to develop a sound data base and collect these data.