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Geo-blocking of goods that require cross-border delivery : A preliminary view of EU policy considerations

By

J. Scott Marcus (Bruegel) and Georgios Petropoulos (Bruegel)

Discussant

Antonin Arlandis (Le Groupe La Poste)

LE GROUPE LA POSTE

Paper main ideas

- The EU regulation on addressing unjustified geo-blocking and other forms of discrimination seeks to address long-standing concerns that relatively few consumers in the EU make e-commerce purchases cross-border within the EU, and that relatively few merchants sell cross-border.

- The regulation does not impose an obligation to serve customers across the EU on any goods that require cross-border delivery. Geo-blocking can be economically justified (cross-border delivery of goods imposes burdens on the merchant).

- However, there is room for efficiency gains that can lead to lower prices, higher consumers surplus, higher demand and higher producers profits according to Duch-Brown and Martens (2016)

- Selling cross-border inevitably entails a range of economic transaction costs.

- A large fraction of e-commerce is outside the scope of the Regulation. If one considers the collective impact of the full range of Digital Single Market legislative proposals, including not only the proposed geo-blocking measures but also the proposed simplification of VAT, increased harmonisation of consumer protection rules, simplification of collection of rights under copyright, and reduction in cross-border parcel delivery prices, the combined impact might approach the levels identified in the study of Duch-Brown and Martens.

- Claes and Vergote (2016) carried out an econometric study for the European Commission. They found that "*on average, cross-border prices are 324 percent higher than their domestic counterpart for letters and 471 percent higher for parcels.*" This estimate is based on published prices of the National Postal Operators, thus may differ from the prices paid by merchants who ship large volumes.

Estimates of societal welfare

- The European Commission (2016) empirical estimated the costs and benefits of the legislative proposal. According to this study if current unjustified geo-blocking practices were to cease, “consumer surplus increase from online purchases of tangible goods could amount to 0.8% on average for the EU28, with variations across Member States”, and that “producer surplus (profits) could increase by 1.0% on average across Member States.

- Duch-Brown and Martens (2016) investigate the welfare impact of lifting geo-blocking restrictions to cross-border e-commerce in the in the UE.

- They relied on a partial-equilibrium structural model using detailed price and quantity data for four consumer electronics product categories. Then, they extrapolated these results to the whole EU28 economy.

- They simulated two different counterfactual scenarios. The first scenario assumed a full lifting of geo-blocking restrictions. The results indicate that consumers would gain about 500 Million € - an increase of 0.7% in consumer surplus – basically due to lower prices and marginally to increased variety of products available. Firms' profits would also increase by 283 Million € (1.3%) from new trade opportunities. The second scenario opened up a “work-around” solution to geo-blocking whereby sellers deliver to a domestic intermediary who ensures onward delivery to the consumer. This scenario produced similar results although smaller in magnitude.

- The extrapolation of these results to the entire EU28 online economy indicate that lifting geo-blocking restrictions would have a positive impact on consumer and producer surplus in all EU Member States. Consumer surplus would increase by 1.2% and profits by 1.4%.

Remarks on the European Commission and the Duch-Brown and Martens studies

- The European Commission study states increased competition should spur innovation
- This study does not seriously estimates the relation between increasing competition and European firms' incentive to invest and to innovate
- According to the economic literature increasing competition can either reduce or increase innovation
- The EU Regulation on geo-blocking might create a transfer from stores sales to online sales
- Welfare analysis should take into account this transfer knowing that American companies are strong in developing e-commerce platforms because there are consequences in term of taxes and employment

Remarks on the European Commission and the Duch-Brown and Martens studies

- There are many hypotheses in the extension where Duch-Brown and Martens extend the results from electronics products to all online goods sales

- Estimated coefficients are used to compute own- and cross-price elasticities at the product level. Own-price elasticities at the product level are in general greater than one in absolute terms. They are on average equal to -3.39 for smartphones, -2.06 for tablets, -1.72 for desktops, and -2.16 for portable computers.

- These four products represent about 60% of total consumer electronics retail sales but not of all products sold online

Selling cross-border inevitably entails a range of economic transaction costs

- **Cross-border shipment of physical goods tends to incur much higher costs than domestic shipment, thus invalidating the basis for a simple non-discrimination obligation as the Commission has put forward in the proposed Regulation.**

- Member States can have individual requirements for packaging, labelling and safety of certain goods (including food, medication, alcohol and tobacco), thus imposing additional compliance costs on merchants who ship cross-border.

- Even though European Directives address consumer protection, implementation in the Member States often goes beyond the requirements of the Directives, thus imposing both a learning burden and additional costs on merchants who sell cross-border.

- **Each Member State has not only different rates for Value Added Tax (VAT), but also different rules as to which goods and services qualify for discounted rates (including in many cases different rates for physical versus equivalent digital goods), thus imposing both a learning burden and additional costs on merchants.**

- The various obligations noted above are transaction costs, but there are more, including increased cost of arranging for payment, and increased risk of fraud (with increased costs of recovery when fraud occurs). Few of these costs have been studied in depth to date.

Are cross-border prices of parcels unjustified and disproportionate?

- Claes and Vergote (2016) carried out an econometric study for the European Commission. They found that "*on average, cross-border prices are 324 percent higher than their domestic counterpart for letters and 471 percent higher for parcels.*"
- This estimate is based on published prices of the National Postal Operators, thus may differ from the prices paid by merchants who ship large volumes, but it is a reasonable starting point for discussion
- This econometric study has several drawbacks according to a study conducted by Copenhagen Economics in 2016. The main one is that the prices analyzed here are not the relevant ones; they clearly overestimate the real prices paid by e-retailers to send goods purchased online to final consumers.
- While public list prices provide information on the maximum price set by postal operators for single-piece products, e-retailers generally will negotiate the rates that they will finally paid according to the volume and the characteristics of the parcels they give to the parcel delivery operator.
- Moreover, to know if shipping fees paid by e-consumers are really disconnected to delivery costs, it is necessary to look at the margin made by e-retailers on this service
- E-retailers have ample choice in delivery operators
- Network externalities in e-commerce platforms can increase their bargaining power
- Copenhagen Economics founded a low correlation between prices charged by e-retailers and the publics listed prices.
- Trough the Regulation on cross-border parcel delivery services the European Commission has taken steps to address unjustified prices.

Cross-border shipment incurs additional costs

- As an alternative approach, some National Postal Operators and parcel delivery operators offer an option where the consumer pays directly to delivery personnel, and this is widely used in some Member States.

- Can you tell us which operators and which countries use this option?

- One could envision a system where the consumer pays the cost of cross-border delivery directly to the delivery service provider. In this case, the price charged by the merchant could be non-discriminatory, since the cost of delivery would be a transaction between the consumer and the National Postal Operators or delivery service.

- This may solve the discrimination among consumers problem and help them pay a fair price however it might reduce e-commerce sales. Consumer might be reluctant to pay twice and to wait for delivery.

Divergences between EU Member States

- Account needs to be taken of the fact that many differences in Member States' legislation, such as those resulting in different national standards or a lack of mutual recognition or harmonisation at Union level, still constitute significant barriers to cross-border trade. Those barriers continue to cause fragmentation of the internal market.

- There are economic heterogeneities across member states in the EU and in the euro area. Is market regulation really efficient even if countries do not completely agree on common policies ?

- Is there unjustified geo-blocking across States in the USA? How are those concerns addressed ?

Thanks for your attention