

The Rt Hon Lord MandelsonSecretary of State for Business
Enterprise & Regulatory Reform**RECEIVED 06 MAR 2009**The Rt Hon Tessa Jowell MP
House of Commons
London
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Thank you for your letter of 23 February, enclosing a copy of a postcard from your constituent, of which you have received many, about EDM 428.

I know that the Royal Mail is extremely important to the country and to the millions of people who use it every day.

In line with our manifesto, the Government commissioned an independent review of the postal services market from Richard Hooper. This was published on 16 December 2008. His report concluded that the status quo in the postal market was untenable and that if change did not occur, the universal service which is the cornerstone of the postal system would be under threat.

The Government is committed to maintaining the universal postal service. We regard it as very important to our economy and society; and Royal Mail is the only company with the capacity to provide the universal service: that is, the ability to collect and deliver letters six days a week to any of the 28 million companies and households in the UK.

The Hooper Report explained how and why Royal Mail is facing major difficulties. Mail volumes used to track GDP closely. In the last three years, this trend has been overtaken as people and businesses are making more use of digital communication: internet, email and text. As a result, the volume of mail posted every day in the UK has fallen by about five million items a day in recent years – and that is including the rise in packet post as a result of internet shopping. The fall in volumes is set to continue with Hooper predicting a decline of between 5 and 7% each year.

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To respond to the changes in the market, Royal Mail needs to modernise, and to do so quickly. Yet the Hooper Report showed that Royal Mail is lagging behind many of its European counterparts. For example, walk sequencing – the last stage of the sorting process – is carried out by hand in the UK. In some European Postal Services 85% of this activity is done by machine.

Royal Mail also has a very large and volatile pension deficit. This was valued at £3.4bn three years ago but is expected to have grown significantly at its formal valuation this year. In 2008, the deficit was estimated at £5.9bn. Paying off this deficit imposes significant costs on the company – currently some £280 million a year - money not spent on improving the company's performance or invested in new products.

Hooper also points out that relations between the management and unions have been poor, characterised by a lack of trust. There has been a similarly difficult relationship between Royal Mail and Postcomm, the regulator.

If we carry on as we are, the pension fund deficit is likely to become a bigger burden on the company, the modernisation that the company urgently needs to face up to technological change will be much more difficult to achieve and the universal service could be under threat.

The Government has accepted Hooper's analysis of the challenges facing Royal Mail. The review proposes a comprehensive package of measures to ensure a profitable future for Royal Mail and to sustain the universal service: a strategic partnership for Royal Mail, tackling the pension deficit and a new regulatory regime.

The Government intends to take forward the recommendations and has started discussions on how best to implement them. It is not a menu from which Government can select just one or two ideas. All are necessary.

Addressing the pension deficit is crucial for the future health of the company and for the future security of pension scheme members. If we ask the taxpayer to take on a liability for this deficit, they are entitled to ask what they are getting in return by way of modernisation of the company.


A strategic partnership can provide that assurance. A partner will not only give Royal Mail access to capital, but practical experience of managing change on a large scale, working closely with the workforce, and the confidence to carry it through.

A partnership potentially gives the Royal Mail the opportunity to be a bigger player in the European postal market at a time when the postal market will be fully opened to competition in the vast majority of member states.

The Government is clear that Royal Mail will remain in public ownership. Any partnership will be on the basis of a minority stake. The Government will continue to own the majority of the company. This is not a privatisation. The third area Hooper looked at was regulation. He recommended transferring the responsibility for regulating postal markets from Postcomm to Ofcom. Appointing Ofcom as regulator of the postal services market will ensure that Royal Mail is regulated in a way which takes account of the competition which the company is facing from a vibrant communications sector. Ofcom's primary duty in relation to the postal sector will be to maintain the universal service.

A partnership for Royal Mail letters will not include the Post Office network. The Government is providing £1.7 billion to subsidise a network of 11,500 Post Office branches. We are keen to see an expansion in the financial and banking services that the Post Office offers are working with Post Office Ltd and with the House of Commons BERR Select Committee on this issue.

Mail companies around the world are having to respond to falling volumes. We cannot simply wish the issue would go away. The proposals we have set out add up to a good deal for the public, a good deal for Royal Mail staff and a good deal for the company. They will give the public greater certainty that the universal service will be preserved for the future. They will give Royal Mail staff greater pension security for the future and they will give the company a greater chance to make the changes necessary in the light of falling mail volumes and greater competition from new technology.

A handwritten signature in black ink, appearing to read 'Peter Mandelson', consisting of a large, stylized initial 'P' followed by the name 'eter'.

PETER MANDELSON