

Postal Price Regulation

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Before the Price Cap (1970 to 2006)

- Prices set under a cost of service regime
- Prices covered forecasted costs plus a mark-up (institutional costs, planned investments, contingency)
- Rates changed approx. every 3 years
- Ensured USPS had enough revenue
- Lengthy process, complaints of large unpredictable rate increases
- Some argued USPS had no incentive to cut costs / increase efficiency



Postal Accountability and Enhancement Act (PAEA)

- PAEA split products into 2 categories with different price regulation
- Market Dominant Products
 - Price cap on each class
 - Each product must cover its costs (factor)
- Competitive Products
 - Each class of mail must cover its costs
 - Competitive products as a whole must cover its costs plus make a reasonable contribution to institutional costs
 - No price cap needed, competition will limit price increases



Price Cap was Thought to be a Win for Everyone

- Mailers will get smaller, predictable rates increases
- USPS will have incentives to increase efficiency and could even retain earnings
- Up until PAEA, single-piece First-Class stamps kept in line with inflation
- It was thought the CPI cap would allow USPS to earn sufficient revenues
- But then.....



...the Great Recession Hit

- Stagnant CPI only allowed for small price increases
- Mail volume fell, especially First-Class Mail volume
- Delivery points kept increasing
- This is a problem
 - Declining economies of density
 - Contribution per delivery point fell



Declining Economies of Density

- As volume declines, the cost of delivery is spread across fewer mail pieces

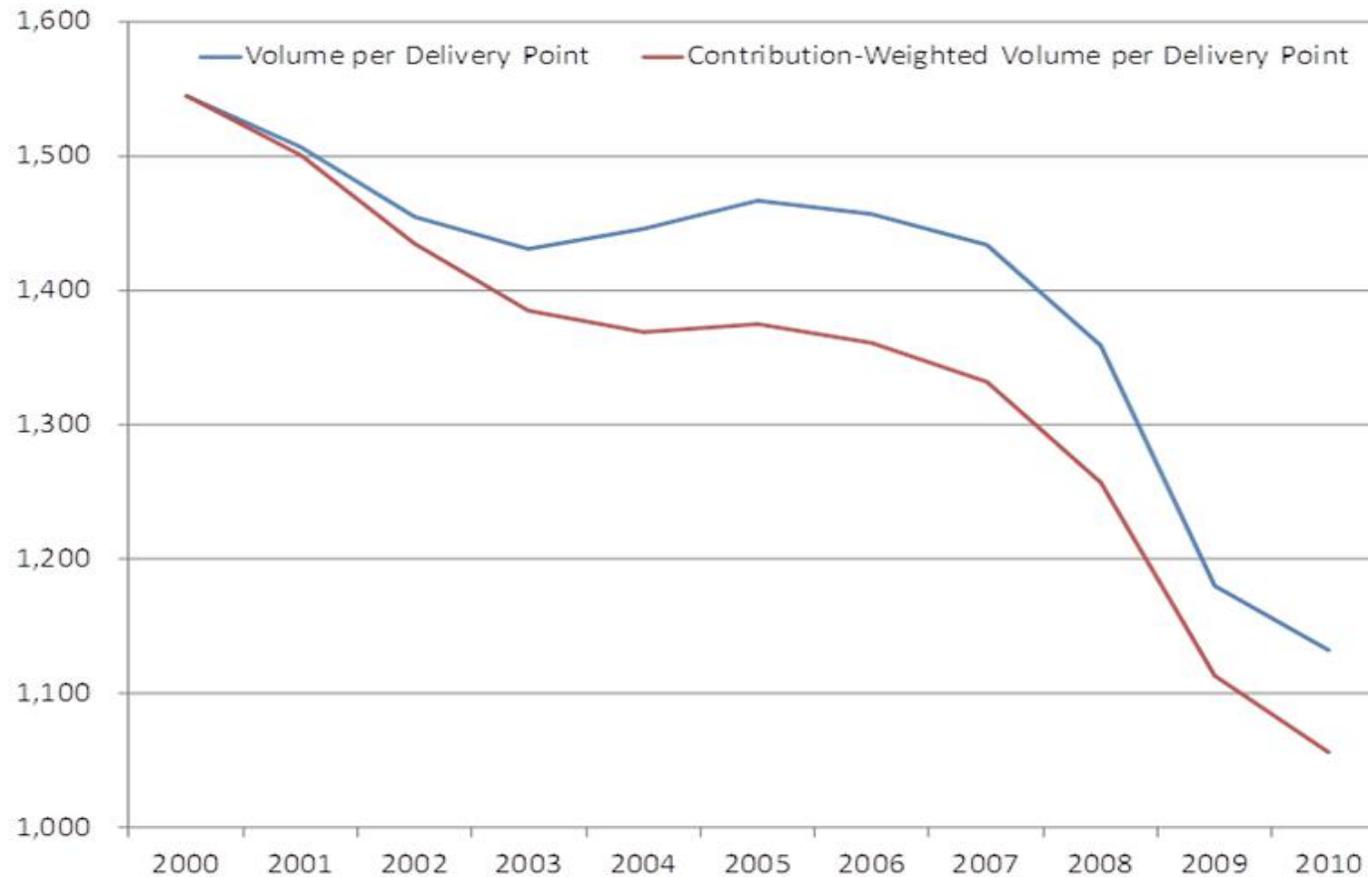


Chart from 2003 Report *Revisiting the CPI-Only Price Cap Formula*

OIG Research (with L.R. Christensen Associates)

- A strict CPI cap does not work with declining volumes, however if it is believed a CPI cap is needed, at a minimum, need to make adjustments.
- So let's look at caps that were designed in other industries with falling volume
- Revenue Per Delivery (RDP) Cap
 - Adjust CPI to allow for constant revenue per delivery point.
 - Problem: encourages no volume growth (or cap goes down)
 - Great for electricity conservation, not so great for USPS

$$\text{RDP Cap} = \text{Change in CPI} - \left(\text{Change in Constant \$ Revenue} - \text{Change in Number of Del. Points} \right)$$

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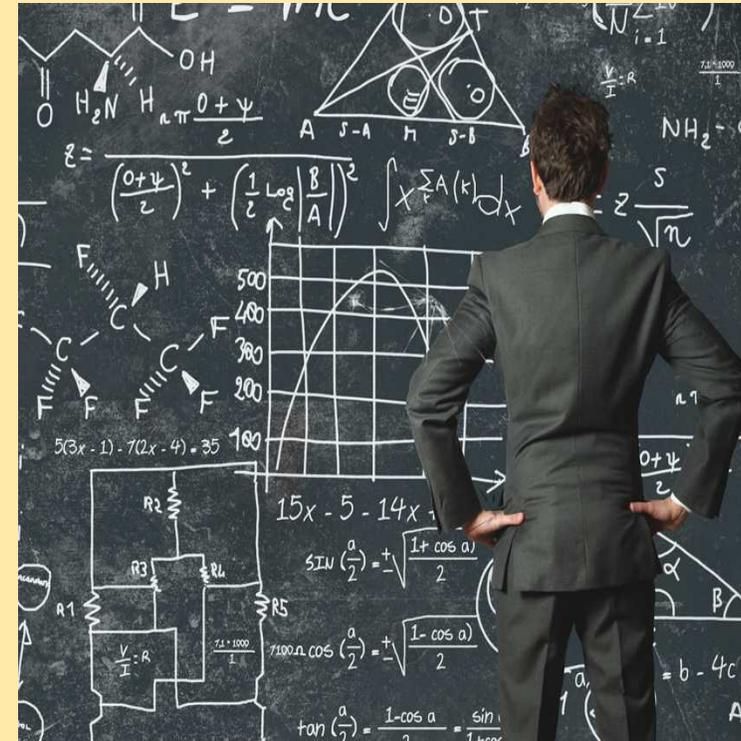
- We also looked at a hybrid cap
 - Similar to the RDP cap, but makes an adjustment to account for the fact that not all costs change with volume
 - Allows Postal a price increase over CPI as volumes fall and delivery points rise, but accounts for the fact that some costs do not vary with volume.
- While our paper discussed X, Y, and Z factors, they were not included in the scenario analysis

$$\text{Hybrid Cap} = \left[\text{Change in CPI} - \text{Share Institutional Costs} \right] \times \left[\text{Change in Constant \$ Revenue} - \text{Change in Number of Del. Points} \right]$$

OIG Research (with L.R. Christensen Associates)

- Ran numerous scenarios and had some interesting findings
 - The CPI cap is financially unsustainable with falling volumes and increasing delivery points
 - The hybrid cap seemed to be the best fit of the three caps we looked at, however....

All the caps resulted in negative net income, except for scenarios that assumed USPS started with break even revenue or received financial help.



Let's not forget the exigent surcharge

- It could be argued that by allowing exigent price increases, the cap can provide USPS enough revenue
- In fact, the temporary surcharge did help USPS financially
- A goal of the cap is for predictable rate increases. But - rates going up and then down and then up – is this what mailers want?
- In an update to the price cap, we showed that by allowing a more generous cap, exigency would not be needed and there would be moderate, predictable rate increase



Maybe there are ideas beyond a strict cap

Need a price regulation scheme that protects mailers but allows USPS adequate revenues

- Allow cap /regulation to change over time (regulator vs written into legislation)
- Is there an appetite for reconsidering which products fall under price regulation ? Or is this already done through moving products from one list to another?
- Is there an appetite to a modified cap? Alternative regulation other than a cap?



Preliminary Research on Other Posts

- We asked WiK-Consult to provide research on price regulation in other countries
- Still a work in progress, but preliminary data shows some interesting findings
- There is price regulation that is not a price cap
- Those posts with caps have altered them as letter volume has declined

