

POSTAL PRICE CAP REGULATION: UNITED STATES EXPERIENCE SINCE 2006

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Caveat

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The views expressed are solely those of the author. They do not represent the opinions of the Postal Regulatory Commission or any of the Commissioners.

Price Cap in the economic literature

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- Initial assessment and rate rebalancing
- X-Factor
- Z-Factor
- Price cap time period before reset
- Reset/Review
- Price cap basket definition
- Exception for new products

Typical Price Cap Applications

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- Access to capital, well-capitalized firm
- Subject to residual claimants
- Industries with growing demand
- Industries with improving technology, productivity
- Firm facing increased competition in that sector

USPS Atypical For Price Cap

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- ❑ Limited access to capital, not well capitalized
- ❑ Not subject to residual claimants
- ❑ Declining demand (except packages)
- ❑ Rate of technological improvement may be slowing
- ❑ Statutory monopolies, no downstream competition
- ❑ Declining demand for service provided principally by a labor-intensive operation (for the USO)

Postal Reform in the United States

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- 1970 Postal Reorganization Act
 - ▣ Cost of service regulation
 - ▣ Litigated omnibus rate cases at irregular intervals
 - ▣ Revenue Requirement + contingency
 - ▣ Regulator recommends rates
- various Amendments to PRA
- 1995 Legislative work begins on postal reform
- 2006 Postal Accountability & Enhancement Act
- ~2017 10 Year Review by the PRC

PAEA Features - MD

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- Separates competitive, market dominant products
- Market Dominant Products Regulatory system
 - ▣ 9 Objectives, 14 Factors
 - ▣ Other provisions of Title 39 including § 101.
- Driver: Regular and predictable rates
- Transparency and Accountability
- Limited time for rate review
- Hallmark of the law: a price cap

PAEA Features - MD

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- CPI-U, 12 month, seasonally unadjusted
- Price cap groups are existing mail classes
- Market Dominant Negotiated Service Agreements
- Unused rate authority
 - “Banking”
 - First In – First Out
 - 5 year expiration

PAEA Features - CP

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- Competitive products must each cover their costs
- Overall competitive products must contribute the defined minimum percentage to institutional costs
- Negotiated Service Agreements

PAEA Features - Other

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- Annual Compliance Determination (ACD) look back
- 5 year legislative recommendations (§ 701 Report)
- 10 year review of the system for regulating rates
- Initial opportunity (in 2007) for one final cost of service rate case

Potential Price Cap Exceptions

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- USPS – initiated: “Exigency” Case
 - ▣ Exceptional or extraordinary circumstances

- PRC - initiated: Noncompliance determination by the regulator (potential)

- Mailer - initiated: Outcome of a formal complaint proceeding (potential)

PAEA Implementation of Price Cap

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- Silent on X-Factor
- Silent on Z-Factor
- Silent on Quality of Service Adjustment
- Required service quality measurement/reporting
- Permitted but did not require assessment of revenue requirement and realignment of rates with costs in a final cost of service rate case (transition rule)

Policy Issues

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- ▣ Loss Making (“Underwater”) Products
- ▣ Changes to Mail Preparation Requirements
- ▣ Quality of Service Adjustments

Technical/Calculation Issues - 1

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- Moving Average vs Point to Point
- Timing Flexibility for Price Adjustments
- Unused Rate Authority
- Deflationary Periods

Technical/Calculation Issues - 2

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- Selection of a Price Index
- Incentives and Promotional Rates
- Rebates
- Rate Decreases
- New Mail Classes or Class Changes

The PAEA Ten Year Review

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- Required to determine if the system is achieving
 - The Objectives of the Act
 - Taking into account the Factors in the Act
- PRC has broad discretion to conduct the Review
- If the PRC determines the system is not achieving...
- It can make modifications to the system or adopt an alternative system
- Wide range of potential courses of action

Conclusions - 1

- PAEA price cap has increased predictability of rates, incented cost reduction and productivity, and substantially reduced the cost and duration of rate proceedings.
- While the price cap system is simple in theory, in practice the interplay of price cap features can create ambiguity and uncertainty and has required clarification.

Conclusions - 2

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- Quality of Service can be under pressure and merits particular attention in a price cap regime.
- Cost shifting from the operator to customers may be perceived by customers as a means of evading the price cap.

Conclusions - 3

- Establishing a price cap regulatory system without first properly restructuring rates to recover all costs, to align rates with costs and to match current market demands can be problematic.
- Periodic revisiting/reset of the price cap mechanism may provide benefits.
- Any renegotiated price cap regime should include an evaluation of revenue requirements and external factors that may impact the initial ability to produce a net surplus (or break even), service debt and satisfy the USO.

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