

GREETING CARD ASSOCIATION

DETAILED ANALYSIS

August 17, 2010

I. Introduction

The ultimate economic, as well as legal, issue in this rate case is whether it is reasonable, equitable or necessary under PAEA's exigency clause, § 3622(d)(1)(E), to raise postal rates at this time. Mailers are facing significant downward pricing pressure in the markets they serve and consumers are facing similar pressure on their household budgets.

The Postal Service has maintained that historically on average, its rate increases have tracked changes, in the CPI fairly well.¹ Ceteris paribus, this conclusion is consistent with increases in postal labor costs tracking the CPI since 80 percent of all postal costs are labor.² However, changes in the CPI include decreases as well as increases, and at times decreases below zero.³

If historically postal rate increases have tracked changes in the CPI, then why not now, when the CPI has been effectively zero for the past eighteen months? GCA believes the economic circumstances which led the Postal Service last October to rule out any rate increase for 2010 apply with equal or greater force today. The Fed's decision on August 10, 2010 to change course in monetary policy and seek more expansionary measures reflects the continuing weakness or worsening of the economy. Mailers cannot absorb any postal rate increase at this time when the CPI has fallen for the three months ending with June, indicating a deflationary trend in the economy at present rather than a continued if weak recovery.

¹ Docket R2010-4, USPS, Statement of Joseph Corbett, p. 4.

² This was true before automated mail processing, and it remains true today.

³ The purpose of the CPI price cap under PAEA was clear. When the cost of living is rising rapidly and inflation is high, a CPI based COLA is intended to keep the real wages or income (and hence, purchasing power) of the recipient the same as if changes in the cost of living were zero. Productivity advances enable real wage increases even when inflation is high. By contrast when inflation is low or deflation exists, there is little or no increase in the cost of living, and a COLA based on the CPI may be small, zero or negative. Social Security beneficiaries received a zero COLA in January of 2010 because the change in the cost of living in the previous year was below zero. If inflation is negative and productivity growth is zero or negative, a zero COLA will still lead to an increase in real benefits or wages tied to the CPI.

Apart from institutional considerations such as the lag between collective bargaining agreements and movements in the economy and some constraints PAEA imposes, it is astonishing that the Postal Service should be asking for any rate increase when 80 percent of its cost structure, i.e. its labor costs, should be stable or falling in a free and open market. Postal rates should be steady or falling because labor rates should be steady or falling in this macroeconomic environment. It is natural to ask why they are not, by comparison with the private sector, which the Postal Service has been shaped by Congress to emulate since the Postal Reorganization Act of 1970, and even more under PAEA.

An equally important, and in some ways logically prior, economic issue in this case is whether the 2008-2009 recession, and its impact on postal volumes constitutes an exigent circumstance under PAEA. In many respects, this is a legal issue, since it involves interpreting statutory language. That aspect of the issue is dealt with in GCA's Comments, where it is concluded that the recession is not "extraordinary" in the statutory sense, but is in part "exceptional."⁴ From the economic standpoint, however, the Commission must decide at least three major questions: Was the 2008-2009 recession an extraordinary or exceptional event in comparison to measures of past U.S. recessions? Which recessions form the basis for such a comparison and why? Is the Postal Service's proposed rate increase lawful under the exigency clauses in PAEA, and if not, what would the maximum lawful average rate increase be? Participants in this case have argued both (i) that the recession as a whole is an extraordinary or exceptional circumstance⁵ and (ii) that no part of it is.⁶ The next section analyzes these arguments.

II. Invalid Arguments

A. All of the Recession Was An Exigent Circumstance

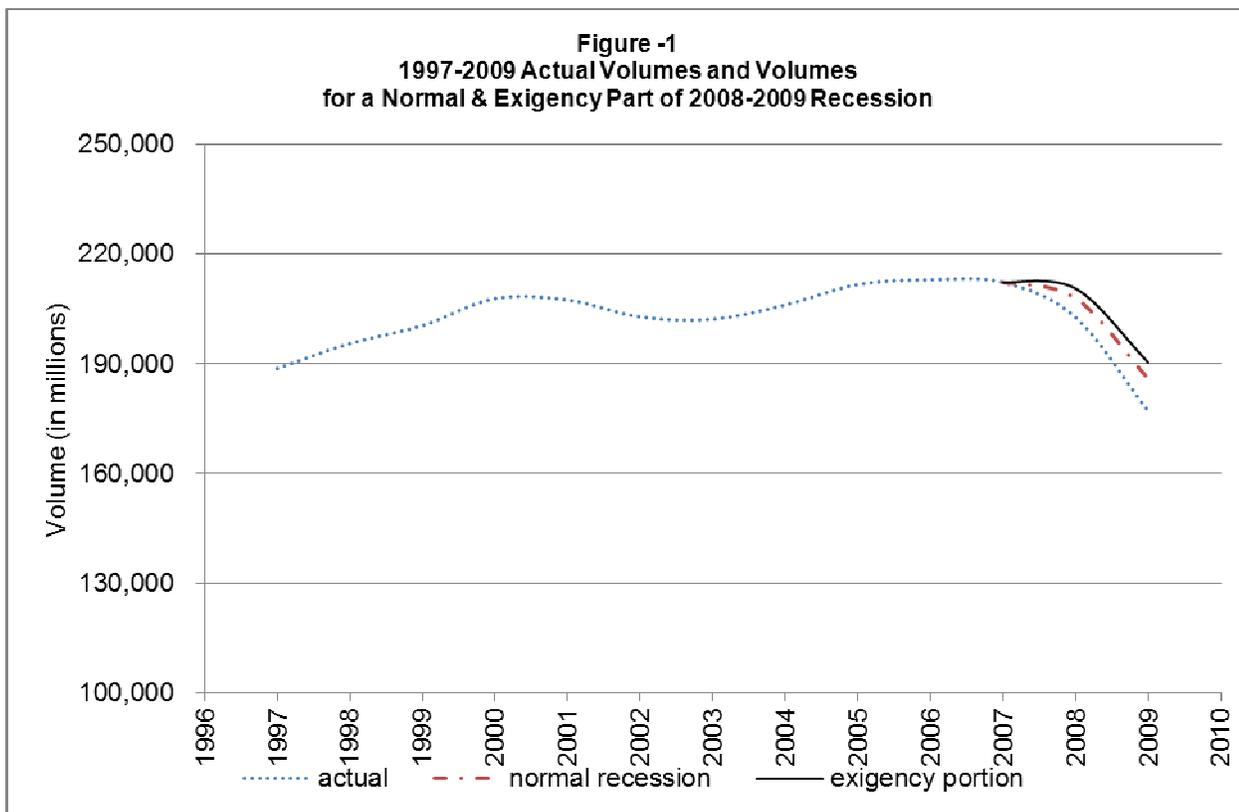
For the purpose of defining exigency in this case, the 2008 and 2009 recession can best be thought of in economic terms as having two components: (a) that portion which

⁴ The Comments also demonstrate why this distinction is required by the statute and necessary for its effective administration.

⁵ This is in essence the Postal Service's view.

⁶ This is the position of the Affordable Mail Alliance, as expressed in its Motion to Dismiss.

made it worse than prior recessions, if any; and (b) that portion representing an average, or typical recession. Conceptually, this is portrayed in Figure One below.



The Postal Service’s case is built on the assumption that the entire magnitude of the 2008-2009 recession and its impact on postal volume was an exigent event.⁷ The Postal Service bases its argument that the 2008-2009 recession is an exigent circumstance in its entirety because it has been substantially worse than any other in “modern American postal history”, and it appears to define that as the post 1970 period.⁸ It does reference the Great Depression, but views that as the only exception (before the 2008-2009 recession) to the rule that any and all U. S. recessions that are worth comparing to the latest are the relatively mild ones since the Postal Reorganization Act, in 1970 or possibly since World War II.

⁷ We use the term “exigent” to refer to circumstances or events which satisfy the first branch of the § 3622(d)(1)(E) standard, without regard to whether they qualify as “extraordinary,” “exceptional,” or both.

⁸ Docket R2010-4, Statement of Joseph Corbett, p. 11, line 8. Other statements by Mr. Corbett talk about the worst decline in mail volume in the previous 35 years combined (line 22). The Request at page 2 refers to the USPS revenue decline in 2009 as the worst “in the post-war era”.

Recessions generally speaking, however, are not the extraordinary or exceptional events defined in PAEA as permitting an exigent increase, for they occur with regularity, if not wholly predictable regularity in terms of their timing and variation. While this recession as a recurring event was not “extraordinary”, its depth and likely its length was exigent in that it was “exceptional”, at least compared to post 1970 recessions.

But the peak to trough of the 2008-2009 recession measured by the fall in GDP, for example, is not the right quantitative measure of the “exceptional” exigent circumstance. Only that portion of the peak to trough in 2008-2009 that exceeded the decline in GDP in a typical recession is exigent, and that percentage depends, in part on what the historical comparisons that define the norm are. What part of the decline in postal volumes attributed by the Postal Service to the recession can qualify as an “exceptional” circumstance allowing it to file an exigent rate increase under PAEA? Clearly, the answer to that question is that: (a) no portion of the 2008-2009 recession that is estimated from the average of comparable past recessions can be viewed as “exceptional” under PAEA, for that average represents the quantitative element of recessions as normally recurring events; and (b) only that portion of the peak to trough measure of the 2008-2009 that exceeds the average historical comparisons can be viewed as exceptional.

If the Commission agreed with the Postal Service position concerning the nature of the recession, it would be setting a legal precedent for the future that seems clearly flawed on economic grounds surrounding the current situation. If it accepted the USPS position, then clearly even the average or below-average recession of the future would have to be viewed as an exigent event. Why? Because if the Commission were to accept this entire recession as an exigent event, it would be saying that the Postal Service should be able to raise rates not just because of the impact the exigent portion of the 2008-2009 recession has had on its finances, but also because of the impact the normal part of the recession (or any part of it) has had on postal finances. Such a precedent would be the end of price cap regulation under PAEA because it would allow the Postal Service to raise rates above the cap in a normal or even milder recession.

B. None of the Recession Was an Exigent Circumstance

If on the other hand the Commission concludes that there is no exigent circumstance at all in this case, it could set an equally bad precedent for postal rate making in the future under PAEA's exigency clause. If the severity of the 2008-2009 recession is not considered an "exceptional" circumstance under PAEA as reflected in part by the depth of postal volume declines, then it is hard to imagine for the future what circumstance it would take for the Commission to accept an exigent rate case under PAEA. An exceptional circumstance may not lead to a rate increase that exceeds the CPI price cap, however, because rate increase may not be reasonable equitable or necessary under PAEA exigency clause.

In short, both the Postal Service's view of the exigency and many private-sector mailers' very different views of it, if adopted by the Commission in this case as its first ruling on what defines an exigency and what does not, could unnecessarily set a precedent that would clearly not be the correct boundary for future consideration of what constitutes an exigent circumstance and the measure of it.

III. An Economic Analysis Comparing Past U. S. Recessions to the 2008-2009 Recession

A. Why Pre-War Recessions Are the Best Comparison for the 2008-2009 Recession

There are arguments for limiting comparisons of a post war recession to relatively recent periods in U. S. history. Unfortunately, if this were any other of the post-war recessions, 1945-2001—the Postal Service's position would be stronger – considerably stronger – than its position is for the 2008-2009 recession. As Nobel Prize winning economist Paul Krugman commented in June of 2009: "This was a pre-war style recession, a morning after brought on by irrational exuberance."⁹

⁹ Quoted by Megan McArdle, The Atlantic, June 17, 2009.

The past set of recessions closest in time to 2008-2009 is not the only or best basis or for comparing them, and that especially holds true for the 2008-2009 recession. In marked respects the recent recession comes closer to resembling pre-war than post-war recessions for reasons explained below. The Center for Geoeconomic Studies at the Council on Foreign Relations in a June 5, 2009 Quarterly Update noted: "The current recession looks more like a prewar recession than a postwar recession or the Great Depression." "Production in this cycle has collapsed relative to the postwar average, but is in line with the prewar average. The current collapse does not compare to that of the Great Depression."¹⁰

What caused the 2008-2009 recession to differ from the past string of post war recessions, all of which were relatively mild? While it will take many years to understand fully the causes of the 2008-2009 U. S. (and global) recession, G-8 policy makers around the world seem to agree that a major reason was the ineffectiveness of their national fiscal, monetary, and capital risk monitoring policies in the face of: (1) the relatively recent transformation into a global market of the traditional U. S. national market for mortgage backed securities (MBS) in housing finance ; and (2) the explosive growth of new and entirely unregulated and unmonitored financial derivatives, especially in collateralized debt obligations (CDOs) and credit default swaps (CDSs) whose use to hedge risk for newcomers in the MBS market grew rapidly in the past decade as foreign countries and their investors purchased those securities.¹¹

Creating supra-national stabilization authorities or more closely coordinating national stabilization policies has become a major G-8 policy goal since late Fall, 2008, to establish policies that are once again effective under this new "laissez faire" environment, one which resembles the pre-war U. S. laissez faire environment where macroeconomic stabilization policies were not only ineffective, but not yet even present.

¹⁰ Council on Foreign Relations, Center for Geoeconomic Studies. Swartz, Paul, Quarterly Update: The Recession in Historical Context, Appendix (June, 2009),

¹¹ See for example, Posner, Richard A., The Crisis of Capitalist Democracy, Harvard University Press, 2010. Posner strongly criticizes modern economics for having completely forgotten Keynesian thinking, but this reflects to some degree the prevailing belief that free markets can solve every problem in today's economy.

As a substantial body of economic research has shown, without effective governmental anti-cyclical policies the business cycle is associated with substantially deeper and longer recessions than a cycle with effective national stabilization policies. The globalization of the MBS market reduced the ability of the Federal Reserve to conduct a national monetary policy that moderated the supply of and demand for housing, a large sector in the macro-economy. Its monetary policy instruments could not impact a global MBS market (and unregulated derivatives) like it could the U. S. national MBS market.¹²

The unchecked growth of the global MBS market aided by unregulated innovations like CDSs created the longest housing expansion in U. S. history and along with it a U. S. and global financial bubble of extraordinary proportions that eventually and inevitably collapsed as the Fed stood helpless, precipitating a major recession in 2008-2009¹³.

For these reasons, the 2008-2009 recession resembles pre-1935 recessions more than it resembles post World War II recessions. In examining the magnitude of exigency in this case, therefore, it is analytically unsound to compare the 2008-2009 recession with just post 1945 U. S. recessions, or even with post 1945 U. S. recessions at all. To quote another Nobel Prize winning economist, Joseph Stiglitz, “The only similar post -Second World War crisis was the 1991 recession, which involved the Savings and Loan institutions, a small part of America's financial system. This crisis involves all of the main players.”¹⁴

B. All U.S. Recessions and Pre-War Recessions

Table One below shows the peaks and troughs for all U. S. recessions for which the National Bureau of Economic Research (NBER) has suitable data, from the 1857 recession

¹² The Fed had influence over a national housing market by virtue of its ability to affect long term interest rates. With the emergence of a global MBS market, the Fed no longer had that influence to nearly the same degree. If the Fed tried to influence long term interest rates or otherwise restrict the capital market for U.S. housing finance, the policies could easily be negated (and were) by selling mortgage backed securities insured by credit default swaps to investors from other countries. (See footnote 11. Talbott discusses this at length in his book Contagion.)

¹³ See for example, Talbott, John R., Contagion, John Wiley & Sons, 2009. Talbott discusses the link between the housing boom and bust with the creation and rapid growth of unregulated derivatives like CDOs and CDSs. Talbott was an investment banker with Goldman Sachs for many years and predicted the U. S. housing crisis well before anyone else.

¹⁴ The Independent, United Kingdom, Livestream March 24, 2008, “J. S.: You Ask the Questions”.

through the present. The last three columns rank each recession by degree of severity defined as months from peak to trough, starting with the worst U.S. recession at the top of the list. Although NBER has not yet officially dated the end of the 2008-2009 recession, until very recently there have been a number of measures that suggest it ended in June or July of 2009. However, in light of the Federal Reserve's August 10th 2010 deliberations, 21 and 24 month recessions ending in October and December 2009, respectively, are also considered. In Table One, the historical ranking of the 2008-2009 recession appears in bold in three rows of the list, corresponding to three different dates for the 2009 trough.

It is useful to compare the three alternative end dates for the 2008-2009 recession to approximate quintiles of severity for all U. S. recessions.¹⁵ The first quintile in Table One lists the seven worst recessions in U. S. history and 2008-2009 would rank near the bottom of that if dated as a 24 month recession, with five recessions being more severe. The 2008-2009 recession dated at 21 months would be near the top of the second quintile, and dated at 18 months it would appear with five other recessions in that quintile also 18 months long.

The question of exigency in this rate case is highly dependent on two factors: (1) the time period used for the recession comparisons; (2) and the dating of the end of the 2008-2009 recession. For example, if the 2008-2009 recession lasted 18 months, using only the peak to trough measure to rank them, then about 62 percent of the recession was an exigent circumstance if only post-war recessions including 2008-2009 are considered in the comparison. However, if all U. S. recessions are used as the comparison, then the 2008-2009 recession was barely 3 percent greater, essentially average, with little or no exigent component under any of the three trough scenarios.

Out of 32 total recessions in recorded U.S. history, excluding 2008-2009, the thirteen most severe all happened before 1935. The only modern American recession that would fall within the thirteen most severe would be the 2008-2009 recession assuming the peak to trough lasted 18 or 24 months. If recessions prior to 1935 are used as the comparison at an average 21.2 months, then the 2008-2009 recession, dated at 18

¹⁵ Approximate here refers to the fact that the 2008-2009 recession is listed three times based on date of severity, and this affects the dividing line between quintiles.

months, was modestly milder , and a 2008-2009 recession dated at 24 months was slightly worse.

Table One
U.S. Business Cycle Expansions and Contractions
Rankings and Quintiles Based on Duration

<u>BUSINESS CYCLE REFERENCE DATES</u>		<u>DURATION IN MONTHS</u>	<u>BUSINESS CYCLE REFERENCE DATES RANKED</u>		
Peak	Trough	Contraction	Peak	Trough	Rank
<i>Quarterly dates are in parentheses</i>		<i>Peak to Trough</i>			
			First Quintile		
June 1857(II)	December 1858 (IV)	18	October 1873(III)	March 1879 (I)	65
October 1860(III)	June 1861 (III)	8	August 1929(III)	March 1933 (I)	43
April 1865(I)	December 1867 (I)	32	March 1882(I)	May 1885 (II)	38
June 1869(II)	December 1870 (IV)	18	April 1865(I)	December 1867 (I)	32
October 1873(III)	March 1879 (I)	65	January 1910(I)	January 1912 (IV)	24
			December 2007 (IV)	December 2009 (IV)	24
			September 1902(IV)	August 1904 (III)	23
March 1882(I)	May 1885 (II)	38			
March 1887(II)	April 1888 (I)	13	Second Quintile		
July 1890(III)	May 1891 (II)	10	January 1913(I)	December 1914 (IV)	23
January 1893(I)	June 1894 (II)	17	December 2007 (IV)	October 2009 (III)	21
December 1895(IV)	June 1897 (II)	18	June 1857(II)	December 1858 (IV)	18
			June 1869(II)	December 1870 (IV)	18
June 1899(III)	December 1900 (IV)	18	December 1895(IV)	June 1897 (II)	18
September 1902(IV)	August 1904 (III)	23	June 1899(III)	December 1900 (IV)	18
May 1907(II)	June 1908 (II)	13	January 1920(I)	July 1921 (III)	18
January 1910(I)	January 1912 (IV)	24			
January 1913(I)	December 1914 (IV)	23	Third Quintile		
			December 2007 (IV)	June 2009 (II)	18
August 1918(III)	March 1919 (I)	7	January 1893(I)	June 1894 (II)	17
January 1920(I)	July 1921 (III)	18	November 1973(IV)	March 1975 (I)	16
May 1923(II)	July 1924 (III)	14	July 1981(III)	November 1982 (IV)	16
October 1926(III)	November 1927 (IV)	13	May 1923(II)	July 1924 (III)	14
August 1929(III)	March 1933 (I)	43	March 1887(II)	April 1888 (I)	13
			May 1907(II)	June 1908 (II)	13
May 1937(II)	June 1938 (II)	13			
February 1945(I)	October 1945 (IV)	8	Forth Quintile		
			October 1926(III)	November 1927 (IV)	13
November 1948(IV)	October 1949 (IV)	11	May 1937(II)	June 1938 (II)	13
July 1953(II)	May 1954 (II)	10	November 1948(IV)	October 1949 (IV)	11
August 1957(III)	April 1958 (II)	8	December 1969(IV)	November 1970 (IV)	11
			July 1890(III)	May 1891 (II)	10
April 1960(II)	February 1961 (I)	10	July 1953(II)	May 1954 (II)	10
December 1969(IV)	November 1970 (IV)	11	April 1960(II)	February 1961 (I)	10
November 1973(IV)	March 1975 (I)	16			
January 1980(I)	July 1980 (III)	6	Fifth Quintile		
July 1981(III)	November 1982 (IV)	16	October 1860(III)	June 1861 (III)	8
			February 1945(I)	October 1945 (IV)	8
July 1990(III)	March 1991(I)	8	August 1957(III)	April 1958 (II)	8
March 2001(I)	November 2001 (IV)	8	July 1990(III)	March 1991(I)	8
			March 2001(I)	November 2001 (IV)	8
December 2007 (IV)	June 2009 (II)	18	August 1918(III)	March 1919 (I)	7
December 2007 (IV)	October 2009 (III)	21	January 1980(I)	July 1980 (III)	6
December 2007 (IV)	December 2009 (IV)	24			
avg (all recessions excluding current 18 months)		17.44			
Avg (all recessions including current 18 months)		17.45			

By contrast, the 2008-2009 recession dated at 18 months does not appear in the twelve mildest recessions in U. S. history whereas nine of the ten total post-war recessions do. If the 2008-2009 recession was 18 months long, there have been 20 recessions milder and 12 recessions more severe. While the average U. S. recession has lasted 17.5 months, dating the 2008-2009 recession at 18 months, the average post-war recession has lasted 11.1 months.

In short, the data from Table One do not in the least support the Postal Service's position in this case that the best comparisons with the 2008-2009 recession in making its case for an exigent rate increase are the post 1970 mild ones closest in time rather than the pre 1935 ones most similar in the prevailing macroeconomic environment. The recession data clearly indicate that the best comparisons are with pre-1935 recessions, not post-war or post 1970 recessions.

An alternative way to compare all past U. S. recessions with that of 2008-2009 is to essentially break them into three groups as shown in Table Two below. While the exact dividing lines between the three classifications "mild", "moderate", and "severe" are subjective to some degree, the 2008-2009 recession would fall at the higher end of the moderate recessions or the lower end of severe recessions depending on when the trough in 2009 is dated. By comparison with other moderate recessions in U. S. history, the 2008-2009 recession dated at 18 months was 17.6 percent higher than the moderate average, the inference being that only 17.6 percent of the current recession and its impact on postal volumes was exceptional and thus exigent.

However, most would define the 2008-2009 recession as a severe one, although this opinion is based more on the personal experience of those alive today than on any economic analysis. Under our classification for a severe recession in Table Two, the 2008-2009 recession lasting 21 months was only about three fifths as severe as the average U. S. severe recession (62.5 percent), and one lasting 24 months was about 70 percent as severe (70.6 percent). By these measures, the 2008-2009 recession in its entirety was not exceptional or exigent.

Table Two
U.S. Business Cycle Expansions and Contractions
Based on Severity of Recessions (Mild, Moderate, and Severe)

<u>BUSINESS CYCLE REFERENCE DATES</u> Mild			<u>DURATION IN MONTHS</u> Contraction Peak to Trough	<u>BUSINESS CYCLE REFERENCE DATES</u> Moderate			<u>DURATION IN MONTHS</u> Contraction Peak to Trough	<u>BUSINESS CYCLE REFERENCE DATES</u> Severe			<u>DURATION IN MONTHS</u> Contraction Peak to Trough
0-10 Months				11-18 Months				>18 Months			
Rank	Peak	Trough		Rank	Peak	Trough		Rank	Peak	Trough	
2	October 1860(III)	June 1861 (III)	8	1	June 1857(II)	December 1858 (IV)	18	4	April 1865(I)	December 1867 (I)	32
1	July 1890(III)	May 1891 (II)	10	1	June 1869(II)	December 1870 (IV)	18	1	October 1873(III)	March 1879 (I)	65
3	August 1918(III)	March 1919 (I)	7	5	March 1887(II)	April 1888 (I)	13	3	March 1882(I)	May 1885 (II)	38
2	February 1945(I)	October 1945 (IV)	8	2	January 1893(I)	June 1894 (II)	17	7	September 1902(IV)	August 1904 (III)	23
1	July 1953(II)	May 1954 (II)	10	1	December 1895(IV)	June 1897 (II)	18	6	January 1910(I)	January 1912 (IV)	24
2	August 1957(III)	April 1958 (II)	8	1	June 1899(III)	December 1900 (IV)	18	7	January 1913(I)	December 1914 (IV)	23
1	April 1960(II)	February 1961 (I)	10	5	May 1907(II)	June 1908 (II)	13	2	August 1929(III)	March 1933 (I)	43
4	<u>January 1980(I)</u>	<u>July 1980 (III)</u>	6	1	January 1920(I)	July 1921 (III)	18	8	<u>December 2007 (IV)</u>	<u>October 2009 (III)</u>	21
2	<u>July 1990(III)</u>	<u>March 1991(I)</u>	8	4	May 1923(II)	July 1924 (III)	14	5	<u>December 2007 (IV)</u>	<u>December 2009 (IV)</u>	24
2	<u>March 2001(I)</u>	<u>November 2001 (IV)</u>	8	5	October 1926(III)	November 1927 (IV)	13				
				5	May 1937(II)	June 1938 (II)	13				
				6	November 1948(IV)	October 1949 (IV)	11				
				6	<u>December 1969(IV)</u>	<u>November 1970 (IV)</u>	11				
				3	<u>November 1973(IV)</u>	<u>March 1975 (I)</u>	16				
				3	<u>July 1981(III)</u>	<u>November 1982 (IV)</u>	16				
					<u>December 2007 (IV)</u>	<u>June 2009 (II)</u>	18				

Note: Dates in bold are post-WWII recessions. Dates underlined are post-1970 recessions.

Source: National Bureau of Economic Research, Inc.

Table Three A below summarizes all the exigency factors for this rate case based on pre-war recessions and all U. S. recessions compared to the 2008-2009 recession and three alternative end dates for that recession.

Table Three A

Exigency Factors for the 2008-2009 Recession

2008-2009 Recession Length	Exigency Factor		
	Mild Recession	Moderate Recession	Severe Recession
18 Months	NA	17.6%	NA
21 Months	NA	NA	0.0% (-40%)*
24 months	NA	NA	0.0% (-30%)*
2008-2009 Recession Compared to:	Exigency Factor		
	18 month trough	21 month trough	24 month trough
All U.S. Recessions, 1857-	3%	20%	36%
Prewar Recessions	0.0% (-13%)*	2%	16%

Source: Table One and Table Two; NBER

*A negative exigency factor results in no exigency, or 0.0 percent.

The table reports percentages of the 2008-2009 recession which can be considered exigent compared to pre-1935 recessions and all U. S. recessions on average. For reasons explained previously, the pre-1935 recessions appear most comparable to the 2008-2009 recession both because their average length in months was similar, peak to trough, and because the macroeconomic environment of the pre-war period has similar

characteristics to 2008-2009 in that effective automatic stabilizers were absent in both periods.

The all-recessions comparisons with 2008-2009 include the post war, and accordingly the post 1970 period the Postal Service uses in its comparisons in this case, but they also include pre-war data. These are also better for comparison purposes than the post war comparison the Postal Service relies on.

The first set of comparisons in Table Three A is based on the earlier classification of pre-war recessions being mild, moderate or severe. For 21 and 24 month dating of the peak to trough, the 2008-2009 recession was 40 percent less severe than the prewar average severe recession, and 30 percent less severe, respectively. On these two comparisons there is no basis for the exigent rate case as the exigency factor defaults to zero for negative exigency factors.

If the 2008-2009 recession is classified as moderate at 18 months, there is a small 17.6 percent exigency factor for the 2008-2009 recession. This means, for example, that of the 36 billion pieces of mail the Postal Service claims it lost over the FY2007-FY2009 period, it could only claim an exceptional exigent circumstance on 17.6 percent of that drop in volume, or 6.34 billion pieces. Recovering revenue lost on that volume would lead to an extremely small increase in rates, not the 5.6 percent average increase the Postal Service seeks.

The second set of percentages in Table Three A are based on comparing the 2008-2009 recession to the prewar average length of recessions and the all U. S. recessions average. If the 2008-2009 recession lasted 18 months, as most data series from BLS and BEA now indicate, then there is no basis for any exigent rate request at all compared to the pre-war average, and only a de-minimis exigency of 3 percent if the comparison is made with all U. S. recessions.

Despite what the individual data series indicate as the 18 month bottom of the 2008-2009 recession, NBER has not officially listed any trough. This reflects the skepticism that many macroeconomists and policy makers have that the recession ended in June 2009. Recent weakness in the economy in 2010, as acknowledged by

the FED on August 10, 2010 also raises doubts about whether a true recovery has actually begun. Accordingly we also examine exigency factors for an October and a December, 2009 trough. The latter trough is 3 months beyond the end of postal FY2009 and the stated volume decline that appears to be the basis for the USPS exigent request.

The main finding evident from this portion of Table Three A is that the exigency factor for this rate case is no more than 36 percent of the decline in postal volume from the 2008-2009 recession dated conservatively as lasting a full two years. A simple weighted average of the four exigency factors for 21 month and 24 month recessions is an 18.5 percent exigency factor that is applicable to the 2008-2009 recession.

In summary, across all dated troughs for the 2008-2009 recession, when compared to the most similar period of past recessions or all U. S. recessions, the exigency factor for this rate case is about 80 percent below what the Postal Service claims, namely that all the postal volume declines from FY2007-FY2009 caused by the recession are extraordinary and exceptional exigent circumstances.

C. Post WW II and Post-1970 Recessions

We have stated in Section III.A. above why pre-1935 recessions, and not post-war recessions, are the best comparison with the 2008-2009 recession. Capital markets in particular through globalization and financial innovation had largely neutralized the influence of post war national stabilization policies by that time or before in the past decade. The re-emergence of laissez faire in U. S. financial markets over the past decade is the single most important reason why the severity of the 2008-2009 recession most closely resembles the pre war average, also a period of laissez faire.

Why, then, look at post war recession data? First, whatever data source(s) the NBER database is constructed from, it is unlikely to be as accurate and methodologically consistent across such a period as 1857-2009 as the BEA and BLS post war data series are. Second, the BLS and BEA data enable us to measure the peaks and volumes in post war recessions with multiple variables that can produce

different results. Looking at all these results and rendering a judgment about the overall evidence however weighted in importance is a more sophisticated and very likely much more accurate way of dating recessions than was available, for example, for the 19th century. Third, there is some merit to comparing recessions that are close in time because secondary influences on them may be more similar.

Several of the recession measures now used by NBER are based on data that only became available on a statistically consistent basis for comparative purposes around the post-war period: payroll employment (1939), real GDP (1947) and real personal income (1947).¹⁶ Based on observation before, during and after the 2008-2009 recession, these are the three best measures of recession currently available. Quarterly data for the payroll employment measure is used since real GDP and real Personal Income data after transfers do not include monthly statistics.

The extent to which the 2008-2009 recession was exigent based on comparisons with post WWII recessions and post 1970 recessions can be estimated using the three economic indicators. The results are shown below in Table Three B.¹⁷ Pre-war data from Table Three A is more limited in macro variables and consistently measured variables compared to post war data, but it is richer in the much larger number of U. S. recessions included. Since part of the discussion below relates to both sets of exigency comparisons, Table Three A is repeated below.

By comparison with the exigency factors in Table Three A, the post war and post 1970 exigency factors in Table Three B are substantially higher, but they are still low by comparison with the Postal Service's 100 percent exigency factor assumption for the 2008-2009 recession. The closest similarity occurs between the 36 percent factor for all U. S. recessions and the 34.2 percent and 40.5 percent factors for post war and post 1970 recessions, all of which use the 24 month dating for the trough of the 2008-2009 recession.

¹⁶ The payroll employment survey samples 400,000 work sites whereas the household survey of employment includes 67,000 households. NBER also considers the household survey, real manufacturing and wholesale-retail trade sales and industrial production in its determinations.

¹⁷ See Appendix A for the work sheets underlying these exigency factors for the post war period.

Table Three A

Exigency Factors for the 2008-2009 Recession

2008-2009 Recession Length	Exigency Factor		
	Mild Recession	Moderate Recession	Severe Recession
18 Months	NA	17.6%	NA
21 Months	NA	NA	0.0% (-40%)*
24 months	NA	NA	0.0% (-30%)*
2008-2009 Recession Compared to:	Exigency Factor		
	18 month trough	21 month trough	24 month trough
All U.S. Recessions, 1857-	3%	20%	36%
Prewar Recessions	0.0% (-13%)*	2%	16%

Source: [Table One](#) and [Table Two](#); NBER

*A negative exigency factor results in no exigency, or 0.0 percent.

Table Three B

Exigency Factors for the 2008-2009 Recession
with Three Variables

	18 month	21 month	24 month
	(unweighted)		
Post War	55.1%	55.3%	44.1%
Post 1970	58.5%	58.4%	48.9%
	18 month	21 month	24 month
	(weighted)		
Post War	53.0%	51.4%	34.2%
Post 1970	56.5%	55.0%	40.5%

Source: Bureau of Labor Statistics (BLS); Bureau of Economic Analysis (BEA).

There are three other primary observations that can be made about Table Three B. First, all the remaining exigency factors for 18 and 21 month dating of the trough range from the low 50th percentile to the high 50th percentile, regardless of the date of trough. Second, it does not matter whether only post 1970 data is used or all post war data is used as the basis for comparison; both sets of exigency factors are always within four percentage points of each other. Third, the weighted exigency factors are uniformly smaller than the exigency factors which use a simple average of the trough for the employment, real GDP, and real personal income variables.¹⁸ Fourth, the simple average of the six cells of unweighted exigency factors in Table Three B data is 48.5 percent.

For examining to what degree the 2008-2009 recession was “exceptional,” a range of exigency factors appears preferable to a point estimate because the exigency factors are so different between pre war and post war recessions.¹⁹ For post war data

¹⁸ These differences are more fully explained in Appendix A., which also discusses the greater accuracy of weighted to unweighted data.

¹⁹ If we were to use the average of post war weighted data with the average of prewar and all U. S. recessions data (other than the more subjective mild, moderate and severe classifications) , we would be comparing a 48.5 percent exigency factor without any influence from pre-war data with a 12.8 percent

based on recent statements about the economy, 24 month period data should be considered more than the other periods and as explained in Appendix A weighted data should also be considered more than unweighted data. A figure of 45 percent is adopted for the upper end of the range, which is the six cells average of 48.5 percent adjusted for greater emphasis on the 24 month dating. Forty-five percent is within the weighted and unweighted range of post war 24 month cells in Table Three B.

The prewar and all U. S. recessions data is a more difficult decision.²⁰ Thirty five percent gives substantial weight to the all U. S. recessions data for 24 months. While 35 percent is a high range if all six cells were considered, it is substantially below the post war data averages and therefore gives some added weight to the impact of pre-war recessions in calculating the maximum allowable exigent rate increase for the lower part of the range. The all U. S. recessions exigency factors are also not dependant on the argument developed in section III A above about the greater comparability of pre war recessions and these alone for use in determining what part of the 2008-2009 recession was exigent. It weights each pre war and post war recession on an equal basis for the comparison with 2008-2009, rather than pre war data alone.²¹

IV. What is the Maximum Potentially Lawful Increase in Postal Rates from the Exigent Portion of the 2008-2009 Recession?

If the only question before the Commission were whether the Request met the “extraordinary or exceptional” standard of PAEA, the conclusion would have to be that the 5.6 percent requested is well in excess of what could be lawfully considered. In

exigency factor without any influence from post war data except in the all U. S. recessions row. The average exigency between the two is 30.6 percent.

²⁰ If the 24 month period as with the post war data is weighted more heavily and averaged with the six cell average , an exigency factor of 19.4 percent is produced. If only the all U. S. recessions data for a 24 month period is considered, we have a figure which is lower and generally considerably lower than the post war data for Table Three B, except for the post-war 24 month weighted exigency factor of 34.2 percent

²¹ The pre war comparison alone is nonetheless a legitimate basis for the Commission to use in determining an exigency factor in this case, and if all three dates for the trough are considered equally, that exigency factor would be in the mid single digits, and effectively zero.

following the ensuing discussion of that issue, however, it is important to bear in mind that this is not the only criterion of § 3622(d)(1)(E), and that under its at least equally important requirement that exigent increases be “reasonable and equitable and necessary” *no increase at all* can be justified in this case.

A. General Considerations

The methodology used can be described in brief, before turning to the results summarized in Table Four and Table Five, which estimates the maximum lawful average percentage rate increase in this case based on postal volumes for the exceptional exigent part of the recession.

The Postal Service’s rate request under PAEA’s exigency clause includes base year (BY) and test year (TY) revenues, volumes and costs, both before rates (BR) and after rates (AR). In this respect it is similar to the rate case method used prior to PAEA. An important difference, however, is that there is no AR break-even point in the determination of TY rates and costs.²² This leaves a certain arbitrariness in the magnitude of rate increases proposed that was not present in general rate cases under the 1970 PRA.

The Postal Service seeks to reduce this arbitrariness by asserting that the proposed rate increase is only one of several measures outlined in a March 3, 2010 set of three outside consultants’ studies designed to bring the Postal Service’s estimated cumulative deficits to a break-even point in 2020, rather than TY2011 in this rate case. There are so many uncertainties associated with the other components of this long range deficit reduction with a 2020 “break even” package that it does not reduce the arbitrariness of the TY2011 rate request by much.

Nonetheless, for the test year if no break even assumption is made, there must still be a test year target or goal with which to work. In this case, the Postal Service is aiming for an after rates TY2011 deficit of \$4,868 million, and it is relying on the other

²² See Appendix B for a more complete assessment of the similarities and differences between the two types of general rate cases.

components of its balanced plan beyond near term rate increases for further deficit reduction. Therefore, conceptually, the maximum lawful average rate increase based on just the exigent part of the 2008-2009 recession is the average rate increase applied to exigent volumes and costs that would achieve the same TY2011 deficit as the USPS request.

Applying the maximum lawful rate increases to the Postal Service's BY and TY volume and cost figures, allowing for the impact of changes in volume due to a different set of TY rates than the USPS request, would of course produce an actual TY deficit that is higher. This means that if the Postal Service is limited under the exigency provision of PAEA to raising rates at most only on the exigent portion of the 2008-2009 recession, it must find other cost saving or revenue producing measures to achieve the same TY deficit target as it has proposed in R2010-4. Resolving the pre-funding issue in retiree health care funds and/or producing more realistic labor contracts are two of the other short run measures available to reduce deficits before the end of TY2011.

In the next section the exigent portion of the 2008-2009 recession is used to calculate the maximum allowable average rate increase for that portion. Would any rate increase apply to the normal part of the recession? Inflation normally recedes in a recession and its immediate aftermath from the levels defining the prior expansion. In the case of the 2008-2009 recession that inflation factor in R2010-4 is essentially 0.0 for the first six months of 2010, and may well come in slightly negative (or slightly positive) for the whole year. This expectation for 2010 and the fact that a price cap adjustment was already made in May of 2008 (3.5 percent) and again in May of 2009 (1.9 percent) that encompassed all of FY2008 and 58 percent of FY2009 (42 percent of calendar 2009) leads one to the conclusion that the price cap for what has been estimated as the normal part of the 2008-2009 recession would have to be no more than 0.0 in R2010-1.²³

²³ For the exigent component it is justifiable to exceed the PAEA CPI-U price cap. For the normal component it is not. The CPI cap would be the most that one could raise rates by for the normal recession portion of the 2008-2009 recession.

The remaining issue therefore is: what is the maximum set of rate increases under PAEA's exigency clause that the Postal Service by law can propose and the Commission can consider in R2010-4?

B. A Method for Estimating Postal Volumes for the Exigent Part of the 2008-2009 Recession

The analysis up to this point implies that there is some average increase in postal rates below the USPS proposed increase of 5.6 percent that is the lawful maximum based on the assessment that on balance between 35 percent and 45 percent of the 2008-2009 recession was indeed an "exceptional" exigent circumstance.²⁴

The first part of the analysis is found in Table Four, which shows postal volume losses in 2008 and 2009 based on the exigency factor, which is 35 percent in the first set of calculations, and 45 percent in the second set.²⁵ This table is based on the last three columns of data from Table C1 and Table C2 in Appendix C, which are the result of derivations from the first nine columns. These include measuring the postal volume declines due to Internet diversion as well as macroeconomic factors. (See Appendix E Figures E1 and E2)

²⁴ The Postal Service's proposed relative rate structure is acceptable to GCA, other than the extra ounce increase for single piece. However, the revenue requirement it has proposed is based on a false assumption that all of the 2008-2009 recession was an exigent circumstance.

²⁵ The Postal Services asserts that in past (i.e., post-1970) recessions mail volume has not declined at all, or only by a small amount. It goes on to argue that this also shows the 2008-2009 recession was entirely exigent because unlike the past, mail volume declined substantially. However, such comparisons with post-1970 recessions can also be used to argue that none of the 2008-2009 recession is exigent insofar as its effect on mail volume is concerned because post-war data shows there is little relation between recessions and mail volume. Therefore, the explanation for the volume declines is due to other reasons such as a gross under-estimate of the extent of electronic diversion from the use of long run rather than short run own price elasticities as broadband prices continue to fall.

Table Four
Mail Volume for Exigent Part of 2008-2009 Recession

Year	35% Exigency			45% Exigency		
	Mail Volume Decline Due to Exigent Part of Recession	Mail Volume for Exigent Part of Recession	Base Year Volume Multiplier Factor for Exigent Part of Recession	Mail Volume Decline Due to Exigent Part of Recession	Mail Volume for Exigent Part of Recession	Base Year Volume Multiplier Factor for Exigent Part of Recession
2008	(4,582.1)	211,213.7	1.042	(5,891.3)	209,904.5	1.036
2009	(7,761.8)	191,472.4	1.0814	(9,979.5)	189,254.7	1.0689

Source: See Table C1 and Table C2 in the Appendix C.

Once the volume losses from the exigent part of the 2008-2009 recession are calculated, Postal Service actual volumes are adjusted upward by the exigent portion of the recession. The ratio of this volume to USPS actual volumes for BY 2009 in R2010-4 is called the base year multiplier, which is used for adjusting estimated USPS TY 2011 BR volumes upward to reflect the impact of the exigency. Intuitively, these TY volumes net out of the actual USPS TY volumes, which incorporate the full impact of the 2008-2009 recession, just the normal part of the volume decline due to the recession, for which USPS cannot be compensated based on the exigency provisions in PAEA.

These adjusted volumes are then used to estimate the average rate increase needed to “compensate” USPS for the exigent part of the recession sufficiently to reach the USPS proposed TY deficit target in this case. If the TY deficit is estimated using the adjusted volumes and USPS proposed rate increases averaging 5.6 percent, TY revenues are above those of the USPS AR TY volumes because the adjusted volumes are higher. One must sequentially reduce the average percentage rate increase from 5.6 percent until an average percentage rate increase is reached that just equals the TY deficit target in this case. The method for doing this is examined in more detail below.

C. A Method for Estimating the Maximum Allowable Average Rate Increase Under PAEA in R2010-4 Based on the Exigent Part of the 2008-2009 Recession

The BY volume multiplier from Table Four is used in the test year volume and financial calculations of Table Five below. The test year revenue and deficit estimates calculated using exigency test year volumes multiplied by the USPS after rates factor yields a deficit of \$3,085 million that is lower than the USPS Test Year deficit of \$4,868 million because test year exigent volumes exceed actual USPS volumes, which reflect both the normal and exigent impact of the recession. The methodology and corresponding tables (Table D1 and Table D2) for calculating attributable costs associated with those volume and revenue estimates is explained in Appendix D.

To calculate the maximum lawful average percentage rate increases under exigent test year volumes that just meet the USPS TY2011 deficit goal, lower average rate increases than the Service’s proposed rates are applied to test year exigent volumes until that deficit grows sequentially from \$3,085 million to the rate case target of \$4,868 million. This is the only solution because lowering the average rate increase below that which is equal to the USPS deficit target would lead to a higher deficit than the target.

Table Five

FY2011 USPS Proposed and GCA Maximum Lawful Rate Increases and Rates for Overall and SP letters

	35% Exigency	45% Exigency
USPS Current Rate for FCM (cents)	44.0	44.0
USPS Proposed Overall % Rate Increase	5.6%	5.6%
GCA Maximum Lawful Overall % Rate Increase for Exigent Part of Recession	3.55%	3.84%
USPS Proposed Overall % Rate Increase	5.60%	5.60%
USPS Proposed % Rate Increase for SP Letters	4.65%	4.65%
GCA Maximum Lawful % Rate Increase for SP Letters	2.95%	3.19%
GCA Maximum Lawful Rate for SP Letters (cents)	45.297	45.402

Source: Table C1 and Table C2 in Appendix C.

As shown in Table Five a maximum lawful 3.55 percent average rate increase across all mail volume is the result associated with the 35 percent exigency factor in the first column of data. If the same structure of rates is used as that proposed by USPS, a maximum lawful increase of 2.95 percent increase would apply to the current First-Class single piece letter rate.

With a 45 percent exigency factor in the 2008-2009 recession as seen in that column of Table Five, a 3.84 percent average percentage increase in rates is the maximum warranted lawfully under PAEA. Under the rate structure USPS has proposed in this case, the whole integer rounding convention leads to a maximum lawful one cent rate increase on First Class single piece letters under either a 35 percent or 45 percent exigency.²⁶

²⁶ By rate structure we mean the ratio of the proposed rate increase for a postal product or service divided by the overall average rate increase of 5.6 percent. Applying this rate structure to our average rate increase of 3.55 percent in a 35 percent exigency scenario yields a stamp price for the first ounce of 45.297 cents as shown in Table D1-e of Appendix D. Applying it to an average rate increase of 3.84 percent under a 45 percent exigency scenario yields a stamp price of 45.402 cents.

V. Can Mailers Afford Any Postal Rate Increase at This Time under PAEA's Reasonable, Equitable and Necessary Provision?

A. Evidence from CPI Comparisons with Recent Postal Rate Increases

Of particular importance in assessing the economic merits of the Postal Service's exigent rate request for an average 5.6 percent increase in prices is how it compares not only to the all-items CPI of the past few years from 2007 to the present. It is equally important to compare its price changes at the microeconomic level in two ways: first within the BLS-defined retail industry sector in the CPI-U where it competes—communications; and second, with sectors in the PPI that are heavy users of the mail such as financial services, advertising and catalogs and periodicals.²⁷

Table Six compares postal pricing in recent years with the macroeconomic all-items CPI as well as the BLS communication sector in which postage appears as one line item.

Table Six is based on December to December annual changes in the all items CPI-U and the two listed detailed components, rather than the fiscal year basis used by the Postal Service. The years selected encompass the period leading up to a peak in economic activity in late 2007 and includes postal data reflecting the impact of the last traditional rate case under the PRA as well as the first two annual price cap changes under PAEA.

²⁷ The BLS produces two macroeconomic indicators of changes in price, a retail indicator of changes in the cost of living, the CPI, and an indicator of changes in wholesale prices, the PPI. However, the detailed CPI and PPI from which the aggregate or macroeconomic indicators are constructed are based on price changes by industry or sector. The CPI is based on changes in the retail prices of consumer goods and services measured by changes for the first 18 days of every month. The PPI is measured on Tuesday of each month and is the change in the revenue received per item. In the detailed CPI Postage is viewed as a segment of the overall Communications Sector, which also includes delivery services, telephone and wireless services, telephone and electronic hardware, Internet services and electronic information providers, and personal computers and peripheral equipment. This CPI detail classification has been consistent for several years. The PPI has generally measured postal services as part of delivery or transportation classifications.

Table Six
Recent Percentage Changes in the Detailed CPI-U

Period	All Items	All Communication	Postage Line Item
2005-2006	3.2	-0.7	5.3
2006-2007	2.8	-0.9	2.5
2007-2008	3.8	1.0	3.4
2008-2009	-0.4	0.9	4.9

Source: Bureau of Labor Statistics, CPI Tables, Archived CPI Detailed Report Tables October 2000-current, Annual average indexes CPI-U, Table 1A and Table 3A

Traditional rate cases under the PRA did not raise postal rates annually as is now the case with price cap regulation under PAEA. Thus, the first row in [Table Eight](#) indicates postal prices rose by 5.3 percent in 2006, higher than the all-items CPI of 3.2 percent for that year. However, in the two prior years the BLS data (not shown) indicates no increases for postal prices following a reported 5 percent rate increase in 2003. The 2003-2005 period illustrates the multi-year period between traditional rate cases under the PRA.

[Table Six](#) indicates that in the first two years under PAEA, 2007 and 2008, price cap regulation worked as it was intended to; postal rate increases were a little less than the increase in the all items CPI-U. The last period for annual data is December 2008 to December 2009, the deepest period of the recession. While the all items CPI-U fell by -0.4 percent, the deflation reflecting how severe the recession was, postage at the retail level advanced by 4.9 percent in the BLS data base, and annual price cap regulation did

not work well.²⁸ Despite the “postal recession” in mail volume starting after the peak in 2006, and continuing throughout 2007 and the first year of the macroeconomic recession in 2008, postal prices were raised in May of 2009 by 1.9 percent at a time when prices in the rest of the economy generally were falling.

In calendar 2010 to date the CPI-U has declined for the past three months by either -0.1 percent or -0.2 percent, whereas in the first three months of the year the changes were either 0.0 percent or the same magnitudes as April –June but positive. Overall through the first six months of 2010, the CPI-U has increased by less than one-tenth of one percent, +0.09 percent. In focusing on the fact that rates have not been raised in nearly two years and not raised at all in calendar 2010, the Postal Service’s request in this case conveniently ignores another fact. Both calendar 2009 and 2010 to date are periods of either deflation or no increase in the CPI, whereas USPS has already increased rates by 1.9 percent in 2009.

The decision to not raise postal prices in calendar year 2010 is likely to track the overall CPI-U for calendar year 2010, and follows two rate increases in 2008 (3.5 percent) and 2009 (1.99 percent) that overlap the period the U. S. was in the 2008-2009 recession. However, the proposed rate increase of 5.6 percent to take effect in January, 2011 is likely to deviate substantially from a 2011 CPI that will very likely be less than +0.4 percent. This is not a “reasonable” or “equitable” situation under PAEA’s exigency clause.

The Postal Service’s proposed 5.6 percent rate increase to take effect January 2, 2011 cannot be justified on the grounds that “the price changes sought in this proceeding would be the first market dominant price changes in nearly two years”²⁹ The Postal Service decision was correct for 2010, but the price cap increase in 2009 in the middle of a deflation was not (but was dictated by the PAEA price cap, not managerial discretion).

²⁸ The deflation in calendar year 2009 was instead recognized in October of 2009 when PMG Potter announced there would be no postal rate increase in 2010.

²⁹ Since May of 2009, 19 months. Source: R2010-4, USPS, Exigent Request of the United States Postal Service, p. 5.

An equally significant CPI comparison for recent postal pricing changes is microeconomic in character. On the supply side, the recent evidence from Table Six (as well as this entire decade regardless of the stage of the business cycle) is that postal price increases have been markedly higher than the average price increases in the BLS/Census sector in which it competes, Communication.

B. Evidence from PPI Comparisons with Recent Postal Rate Increases

The PPI also shows for the recent period how well postal services have competed in a wholesale sense within its BLS/Census classification as part of delivery and warehousing or transportation and warehousing sectors. Care must be taken because the benchmark CPI and PPI numbers for comparisons of price changes differ per year for postal services as between the two indexes because the CPI is measuring changes in the cost of postage at the retail level for households, whereas the PPI is sampling changes in the cost measured as the revenue received by the Postal Service per item. Nonetheless, the overall conclusions that must be drawn are similar to those of the CPI comparison of postal services with Communication.³⁰ In competing for advertising dollars, delivery and transportation services, as well as with telecommunications providers of telephone and Internet text-messaging, postal service pricing has not compared favorably over the recent period, as seen from Table Seven.

The Postal Service has also raised its prices well above what major mailers have been able to support in the market in their own price increases. Table Eight includes all the indicators that are available in the PPI by major class of mail. For use in comparisons with postal price, the PPI has the advantage that it is the most statistically consistent publicly available data across a wide range of sectors for this period.³¹ Some

³⁰ In Table Two comparisons with Internet competition is excluded, whereas in Table One All Communication includes Internet pricing. Nevertheless, the conclusions are the same.

³¹ The PPI includes data for a wide range of mailers or inputs that mailers use that cover all the major classes of mail, but does not include a comprehensive coverage of all mailer groups as that is not its purpose. However, private data from sources such as the UPS and FEDEX price data cited by the Postal Service in its response to the AMA Motion for Dismissal are not useful for a host of reasons. These are published rates and the prices actually charged by UPS and FedEx for major customers tends to be lower especially in a major recession. By contrast, the PPI survey measures prices actually charged per item. Furthermore, there is no way of knowing from industry or private statistical sources whether their

Table Seven

Recent Pressure on Prices for Competitors of the Postal Service (2006-2009 Changes in Producer Price Index, December to December)

	2009	2008	2007	2006
<u>Postal References:</u>				
Postal PPI	3.5	2.8	6.6	6.3
Postal CPI	5.0	3.2	4.4	5.0
<u>Postal Service Competitors (Other Than Internet-Based):</u>				
Telecommunications	-0.6	0.2	1.2	2.3
Wireless telecom carriers	-4.5	-5.9	-3.2	-1.0
Cellular and other wireless carriers	-4.6	-6.1	-3.5	-1.1
<u>Delivery Service and Transportation Competitors:</u>				
Local messengers and local delivery	-1.8	6.0	2.9	2.0
Scheduled freight air transportation-freight	-7.6	13.4	5.3	-1.3
Scheduled freight air transportation-mail	1.0	7.3	1.4	0.1
Truck transportation	-1.3	0.0	3.7	1.9
General freight trucking local	-0.1	-0.5	6.1	3.2
General Freight trucking long distance	-1.9	-2.2	3.9	2.0
LTL trucking long distance: less than truckload	0.1	-3.3	4.8	4.1
<u>Competitors for Advertising Dollars:</u>				
Broadcasting, Except Internet	-4.9	5.3	-2.5	2.7
Radio broadcasting	-1.0	-1.5	-0.9	0.0
Television broadcasting	-5.9	-0.5	-4.9	7.1
Cable networks	-5.9	8.8	-2.1	0.6
Cable Network advertising services	-15.5	16.1	-6.5	-4.5
(See Also Table Ten for Newspaper Publishers)				
Average % Change in Items PPI Including Postal	-3.19	2.49	0.77	1.53
Average % Change in PPI Items Excluding Postal	-3.63	2.47	0.38	1.21
Postal PPI	3.5	2.8	6.6	6.3

Source: U.S. Bureau of Labor Statistics, PPI Detailed Reports 2006-2009, Table 5. Producer price indexes for the net output of selected industries and their products, not seasonally adjusted

of these indicators correspond closely to the markets mailers sell into, while other indicators are proxies of those sales prices represented by changes in the PPI for inputs used by mailers in the products and services they sell. As shown in Table Eight below

methodology for measuring prices or price changes is consistent with how other industries or statistical services measure the same. The PPI is therefore the most comprehensive tool available for comparing postal price increases in recent years with what its competitors charge and with what mailers have been able to charge.

mailers have clearly been unable to pass through the increasing costs of postage during most of this period.

Table Eight

**Recent Market Pressure on Prices Mailers and Their Suppliers Charge
(2006-2009 Changes in Producer Price Index, December to December)**

	2009	2008	2007	2006
<u>Postal References:</u>				
Postal PPI	3.5	2.8	6.6	6.3
Postal CPI	5	3.2	4.4	5
<u>PPI for Mailers Using First Class:</u>				
Commercial Banking	0.4	-8.3	-5.4	0.2
Savings institutions	1.1	-5.1	-1.9	6.1
CPI financial services	-4.9	2.4	3.2	3
CPI checking account and other bank services	-4.9	1.5	1.9	1.2
<u>PPI for Inputs Used by First Class Mailers:</u>				
Envelope manufacturing: Envelopes, commercial, Stationery	-0.3	4.5	3.8	5.1
Greeting Card publishers	0.2	-0.4	2.3	-0.6
Greeting Card publishing	0	-0.5	N/A	N/A
<u>PPI for Advertising Mailers (Standard Mail Users):</u>				
N/A				
<u>PPI for Inputs Used by Standard Mailers:</u>				
Envelope manufacturing: Envelopes, commercial, Direct Mail advertising printing	-0.3	4.5	3.8	5.1
Directory and mailing list publishers	1.4	2.1	2.9	1.2
<u>PPI for Periodical, Catalog, Mail-Order and</u>				
Newspaper publishers	1.9	1.8	2.3	2.6
Periodical publishers	2.5	2.7	4.4	2.4
Specialized Bus and prof periodicals, advertising	1.2	4.1	2.5	6
General and consumer periodicals, advertising	0.9	3.1	5.1	2.2
Catalog and directory publishing	0.2	9.5	5	0.8
Electronic shopping and mail-order houses	2.1	4	5.3	N/A
<u>PPI for Inputs Used by Periodical, Catalog or</u>				
Newsprint	-31.3	33	-17.5	9.2
Magazine and periodical printing	-3.7	0.9	0.9	1.6
Catalog and directory printing	-1.9	0.5	1.2	1.8
Average Including Postal	-1.60	3.13	1.34	3.03
Average Excluding Postal	-1.86	3.15	1.06	2.85
Postal PPI	3.5	2.8	6.6	6.3

Source: U.S. Bureau of Labor Statistics, PPI Detailed Reports 2006-2009, Table 5.
 Producer price indexes for the net output of selected industries and their products,
 not seasonally adjusted

For 2006, 2007, and 2009 Postal price increases exceeded those of mailers' by several multiples. Only in 2008 did mailer price changes exceed those of the Postal Service, and the difference overall was negligible, with half the PPI reports being below Postal increases.

The USPS response to the Motion of the Affordable Mail Alliance (AMA) to Dismiss Request criticized it partly on the grounds that the AMA makes “manifestly misleading”, “naïve”, or “glib” comparisons with the private sector.³² In terms of pricing comparability at least, the findings from Table Eight rebut any claim the Postal Service has made (or can make) that mailers or their suppliers in general have also had price increases during the recession that on balance approximate those of the Postal Service.

The USPS also argues that no comparison with price changes in the private sector over this period can be made (especially with UPS and FedEx) because only the Postal Service has unique labor contracts, retirement plans, laws and regulations with which it must comply. The private sector that USPS asserts has far fewer restrictions on it in fact has federally mandated regulatory constraints alone which have been estimated to cost \$1.1 trillion in 2004, of which \$648 billion was the direct burden on business. The average cost of these per firm for all manufacturing companies from small to large was \$548,077 per firm, or \$10,175 per employee. Outside manufacturing the cost of the federal regulatory burden on “other” business was \$17,636 per employee.³³

The Postal Service may have some different constraints on its operations than the private sector (as well as some similar ones), but it is far from evident that it has had more constraints or more costly constraints to contend with than the private sector. It is hard to imagine the typical firm during the recent recession, or even today with deflation or no inflation the continuing norm, going to its Board of Directors and telling them it has

³² Most of the comparisons the AMA makes are based on magazine or newspaper articles, speeches and press releases and general or specialized news services on-line. (AMA, pages 1, 28, and 30 footnote 12, respectively)

³³ Source: Crain, Mark W. 2005. The impact of regulatory costs on small firms. Small Business Research Summary No. 264. Washington, DC Office of Advocacy, Small Business Administration. “Other” is defined in the study as Total minus manufacturing, healthcare, services and trade.

to raise its prices because of all the constraints regulations put on its ability to cut costs and capacity.

VI. Conclusion and GCA Recommendation

As indicated in section V., raising prices on mailers by an average 5.6 percent cannot be supported by the recent and prospective pricing pressures they face, as revealed by 2006 – 2009 changes in the PPI and CPI relative to recent past and newly proposed rate increases by the Postal Service. Changes at the retail level indicate that the Postal Service is seeking a rate increase in the middle of a mildly deflationary national economy. Inflationary price increases in the CPI such as the USPS is proposing for its 2011 rates happen at most in strong expansions, not the severe recession and weak recovery the United States has experienced since late 2008. The price increases USPS is proposing are also well above what the retail price trends have been for its competitors in the Communication sector of the CPI.

Changes in all of the PPI components which relate to the mailing industry since 2006 show that mailers in general are in no position to absorb a postal rate increase given the downward pricing pressures in the markets into which they sell. Changes in the Postal PPI have greatly exceeded what mailers can absorb as measured by, and compared to, the PPI line items applicable to the mailing industry. Mailers have already absorbed two postal rate increases since the recession began. In most cases those have exceeded what their markets can bear. A third rate increase, the largest proposed in several years, would just add insult to injury, and possibly be a tipping point for the Postal Service's viability as an organization.

The GCA believes that no rate increase is reasonable for calendar year 2011 for exactly the same reasons the Postal Service cancelled any rate increase for 2010. The past three months' changes in the CPI-U have been negative through the end of June, and the July figure was only 0.1 percent excluding the volatile energy sector. This has raised the fear of further deflation and a "double dip" recession in 2011. When the Postal Service canceled any 2010 rate increase in October of 2009, the economy was

just starting to recover and the prospects for 2010 at that time looked better than they do now for 2011.³⁴

The GCA further respectfully submits that the maximum lawful increase in rates in this case must be strictly limited to the exigent portion of the decline in mail volume since 2007 caused mainly by the recession and perhaps accelerated e-diversion caused by the recession. The GCA's position of no rate increase is supported by a comparison of the 2008-2009 recession with the past recessions that most resemble it. These are the pre war recessions, not the post war recessions that USPS has exclusively relied on in justifying its rate proposal.

Even so, if only post-war recessions, and/or all U. S. recessions are the comparisons made to the 2008-2009 recession, the exigency factor that can lawfully be applied in R2010-4 is less than half the Postal Service's claim that the entire recession was an exigent circumstance. The methodology established in sections III. and IV. determines what portion of the 2008-2009 recession (and associated drop in mail volume) was exigent and was not, and then determines a set of maximum lawful rate increases associated with the estimated exigent portion that achieves the USPS TY2011 deficit reduction target in this case.

GCA strongly believes that under the ultimate statutory standard of reasonableness, equity, and necessity, no increase can be approved in this Docket. Even if that were not true, however, the macroeconomic methodology described above defines the maximum legal limits, under the statutory prerequisite of "extraordinary or exceptional circumstances," up to which the Postal Service can propose a rate increase and that the Commission can lawfully consider. Under § 3622(d)(1)(E) taken as a whole, the justifiable rate increase in this case is 0.0 percent -- or, to put it more simply, there should be no increase whatever. The maximum lawful average rate increase in this case under PAEA's "extraordinary or exceptional" standard, taken

³⁴ In its monthly meeting on August 10, 2010, the Federal Reserve acknowledged the seriousness of the weakness in the U. S. economy going forward and announced a set of stimulative monetary policy measures.

alone, would be an average 3.55 percent - 3.84 percent, depending on what exigency factor is used, and not the Postal Service's proposed 5.6 percent.

Appendix A

The severity of recessions on average as measured by the real GDP and Personal Income measures are nearly identical for post WWII and post-1970 recessions, while the employment variable is moderately higher for the post WWII data. Tables A1-A3 uses the NBER reference dating for each variable. Table A4 uses a judgment for the shaded areas where the variable indicates a different reference dating than NBER. The differences are relatively minor.³⁵ First, averages for each recession dating variable based on percentage changes from Peak to Trough are developed. For the 2008-2009 recession a conservative assumption is made that it ended in October 2009. The average percentage declines for each variable are compared with their 2008-2009 counterparts. Exigent is defined as that portion of each variable that exceeds the post-war or post-1970 average for that variable. Lastly, the percentage of each variable's total percentage decline that constitutes the exigent part of the 2008-2009 is computed.

In general, the latter percentages indicate that over half of the 2008-2009 recession was due to exigent conditions. The simple average for all three variables using both post war and post 1970 dating as well as both NBER and an independent judgment of dating is 57.8 Percent. Are all the variables of equal importance?

Changes in personal income (or personal disposable income) probably best reflect changes in the demand for mail products used by individuals and households such as transaction mail in First Class, but not necessarily the demand for postal products as a whole. Such mail is a declining part of the mailstream. Advertising mail has overtaken First Class mail in total volume, and one would expect the GDP measure to be the best measure of short run (or business cycle) changes in the demand for Standard mail. The employment measure may be the best variable for dating the Peak and Trough of a recession more than the demand for mail over the business cycle.

³⁵ The differences are negligible for the Personal Income variable and relatively minor for the Real GDP and Employment variables.

Table A1

U.S. Business Cycle Expansions and Contractions
Based on the NBER Reference Dates and Assuming 18-Month Cycle for the 2008-2009 Recession

<u>BUSINESS CYCLE</u> <u>REFERENCE DATES</u>		<u>Employment</u>				<u>Real GDP</u>				<u>Personal Income</u>			
<u>Peak</u>	<u>Trough</u>	<u>Peak</u>	<u>Trough</u>	<u>% Change</u>	<u>Rank</u>	<u>Peak</u>	<u>Trough</u>	<u>% Change</u>	<u>Rank</u>	<u>Peak</u>	<u>Trough</u>	<u>% Change</u>	<u>Rank</u>
November 1948(IV)	October 1949 (IV)	45,194.0	42,950.0	-5.0%	2	1,869.8	1,840.3	-1.6%	7	1,360.6	1,324.4	-2.7%	3
July 1953(II)	May 1954 (II)	50,536.0	48,965.0	-3.1%	4	2,368.2	2,308.4	-2.5%	5	1,701.0	1,661.5	-2.3%	5
August 1957(III)	April 1958 (II)	53,128.0	51,026.0	-4.0%	3	2,618.9	2,536.6	-3.1%	3	1,935.9	1,887.9	-2.5%	4
April 1960(II)	February 1961 (I)	54,812.0	53,556.0	-2.3%	6	2,834.4	2,819.3	-0.5%	10	2,077.9	2,078.8	0.0%	10
December 1969(IV)	November 1970 (IV)	71,240.0	70,409.0	-1.2%	9	4,263.3	4,256.6	-0.2%	10	3,214.3	3,224.1	0.3%	11
November 1973(IV)	March 1975 (I)	77,909.0	76,649.0	-1.6%	7	4,953.1	4,795.3	-3.2%	2	3,773.8	3,588.6	-4.9%	2
January 1980(I)	July 1980 (III)	90,800.0	89,832.0	-1.1%	11	5,908.5	5,776.6	-2.2%	3	4,352.7	4,291.6	-1.4%	7
July 1981(III)	November 1982 (IV)	91,594.0	88,770.0	-3.1%	5	6,030.2	5,871.0	-2.6%	2	4,510.9	4,497.3	-0.3%	9
July 1990(III)	March 1991(I)	109,775.0	108,535.0	-1.1%	10	8,059.5	7,950.2	-1.4%	6	5,919.1	5,814.0	-1.8%	6
March 2001(I)	November 2001 (IV)	132,500.0	130,901.0	-1.2%	8	11,297.2	11,380.1	0.7%	6	8,458.5	8,381.1	-0.9%	8
December 2007 (IV)	June 2009 (II)	137,951.0	130,640.0	-5.3%	1	13,391.2	12,901.5	-3.7%	1	9,669.6	9,105.5	-5.8%	1
Average for Post WWII				-2.6%		-1.8%				-2.0%			
Exigent Factor				-2.7%		-1.8%				-3.8%			
Degree of decline due to exigency				50.4%		49.6%				65.3%			
Weighted Average (30% Employment, 50% GDP, and 20% Personal Income)						53.0%							
Average for Post 1970				-2.1%		-1.8%				-2.1%			
Exigent Factor				-3.2%		-1.9%				-3.7%			
Degree of decline due to exigency				60.7%		51.2%				63.7%			
Weighted Average (30% Employment, 50% GDP, and 20% Personal Income)						56.5%							

Sources: National Bureau of Economic Research (NBER); Bureau of Labor Statistics (BLS); Bureau of Economic Analysis (BEA).

Table A2

U.S. Business Cycle Expansions and Contractions
Based on the NBER Reference Dates and Assuming 21-Month Cycle for the 2008-2009 Recession

<u>BUSINESS CYCLE</u>		<u>REFERENCE DATES</u>											
Peak	Trough	Employment				Real GDP				Personal Income			
		Peak	Trough	% Change	Rank	Peak	Trough	% Change	Rank	Peak	Trough	% Change	Rank
November 1948(IV)	October 1949 (IV)	45,194.0	42,950.0	-5.0%	2	1,869.8	1,840.3	-1.6%	7	1,360.6	1,324.4	-2.7%	3
July 1953(II)	May 1954 (II)	50,536.0	48,965.0	-3.1%	4	2,368.2	2,308.4	-2.5%	5	1,701.0	1,661.5	-2.3%	5
August 1957(III)	April 1958 (II)	53,128.0	51,026.0	-4.0%	3	2,618.9	2,536.6	-3.1%	2	1,935.9	1,887.9	-2.5%	4
April 1960(II)	February 1961 (I)	54,812.0	53,556.0	-2.3%	6	2,834.4	2,819.3	-0.5%	10	2,077.9	2,078.8	0.0%	10
December 1969(IV)	November 1970 (IV)	71,240.0	70,409.0	-1.2%	9	4,263.3	4,256.6	-0.2%	10	3,214.3	3,224.1	0.3%	11
November 1973(IV)	March 1975 (I)	77,909.0	76,649.0	-1.6%	7	4,953.1	4,795.3	-3.2%	1	3,773.8	3,588.6	-4.9%	2
January 1980(I)	July 1980 (III)	90,800.0	89,832.0	-1.1%	11	5,908.5	5,776.6	-2.2%	3	4,352.7	4,291.6	-1.4%	7
July 1981(III)	November 1982 (IV)	91,594.0	88,770.0	-3.1%	5	6,030.2	5,871.0	-2.6%	2	4,510.9	4,497.3	-0.3%	9
July 1990(III)	March 1991(I)	109,775.0	108,535.0	-1.1%	10	8,059.5	7,950.2	-1.4%	5	5,919.1	5,814.0	-1.8%	6
March 2001(I)	November 2001 (IV)	132,500.0	130,901.0	-1.2%	8	11,297.2	11,380.1	0.7%	6	8,458.5	8,381.1	-0.9%	8
December 2007 (IV)	October 2009 (III)	137,951.0	129,857.0	-5.9%	1	13,391.2	12,973.0	-3.1%	1	9,669.6	9,010.5	-6.8%	1
Average for Post WWII				-2.7%				-1.8%				-2.1%	
Exigent Factor				-3.2%				-1.3%				-4.7%	
Degree of decline due to exigency				54.4%				42.5%				69.0%	
Weighted Average (30% Employment, 50% GDP, and 20% Personal Income)								51.4%					
Unweighted Average								55.3%					
Average for Post 1970				-2.2%				-1.7%				-2.3%	
Exigent Factor				-3.7%				-1.4%				-4.6%	
Degree of decline due to exigency				63.1%				45.3%				66.9%	
Weighted Average (30% Employment, 50% GDP, and 20% Personal Income)								55.0%					
Unweighted Average								58.4%					

Sources: National Bureau of Economic Research (NBER); Bureau of Labor Statistics (BLS); Bureau of Economic Analysis (BEA).

Table A3

U.S. Business Cycle Expansions and Contractions
Based on the NBER Reference Dates and Assuming 24-Month Cycle for the 2008-2009 Recession

<u>BUSINESS CYCLE REFERENCE DATES</u>		<u>Employment</u>				<u>Real GDP</u>				<u>Personal Income</u>			
<u>Peak</u>	<u>Trough</u>	<u>Peak</u>	<u>Trough</u>	<u>% Change</u>	<u>Rank</u>	<u>Peak</u>	<u>Trough</u>	<u>% Change</u>	<u>Rank</u>	<u>Peak</u>	<u>Trough</u>	<u>% Change</u>	<u>Rank</u>
November 1948(IV)	October 1949 (IV)	45,194.0	42,950.0	-5.0%	2	1,869.8	1,840.3	-1.6%	7	1,360.6	1,324.4	-2.7%	3
July 1953(II)	May 1954 (II)	50,536.0	48,965.0	-3.1%	4	2,368.2	2,308.4	-2.5%	4	1,701.0	1,661.5	-2.3%	5
August 1957(III)	April 1958 (II)	53,128.0	51,026.0	-4.0%	3	2,618.9	2,536.6	-3.1%	2	1,935.9	1,887.9	-2.5%	4
April 1960(II)	February 1961 (I)	54,812.0	53,556.0	-2.3%	6	2,834.4	2,819.3	-0.5%	8	2,077.9	2,078.8	0.0%	10
December 1969(IV)	November 1970 (IV)	71,240.0	70,409.0	-1.2%	9	4,263.3	4,256.6	-0.2%	9	3,214.3	3,224.1	0.3%	11
November 1973(IV)	March 1975 (I)	77,909.0	76,649.0	-1.6%	7	4,953.1	4,795.3	-3.2%	1	3,773.8	3,588.6	-4.9%	2
January 1980(I)	July 1980 (III)	90,800.0	89,832.0	-1.1%	11	5,908.5	5,776.6	-2.2%	2	4,352.7	4,291.6	-1.4%	7
July 1981(III)	November 1982 (IV)	91,594.0	88,770.0	-3.1%	5	6,030.2	5,871.0	-2.6%	1	4,510.9	4,497.3	-0.3%	9
July 1990(III)	March 1991(I)	109,775.0	108,535.0	-1.1%	10	8,059.5	7,950.2	-1.4%	4	5,919.1	5,814.0	-1.8%	6
March 2001(I)	November 2001 (IV)	132,500.0	130,901.0	-1.2%	8	11,297.2	11,380.1	0.7%	6	8,458.5	8,381.1	-0.9%	8
December 2007 (IV)	December 2009 (IV)	137,951.0	129,588.0	-6.1%	1	13,391.2	13,149.5	-1.8%	1	9,669.6	8,998.3	-6.9%	1
Average for Post WWII				-2.7%		-1.7%				-2.1%			
Exigent Factor				-3.4%		-0.1%				-4.8%			
Degree of decline due to exigency				55.5%		7.2%				69.4%			
Weighted Average (30% Employment, 50% GDP, and 20% Personal Income)						34.2%							
Unweighted Average						44.1%							
Average for Post 1970				-2.2%		-1.5%				-2.3%			
Exigent Factor				-3.9%		-0.3%				-4.7%			
Degree of decline due to exigency				63.9%		15.8%				67.2%			
Weighted Average (30% Employment, 50% GDP, and 20% Personal Income)						40.5%							
Unweighted Average						48.9%							

Sources: National Bureau of Economic Research (NBER); Bureau of Labor Statistics (BLS);
Bureau of Economic Analysis (BEA).

Table A4

**U.S. Business Cycle Expansions and Contractions
Based on Observed Data Than the NBER Reference Dates**

<u>BUSINESS CYCLE</u>		<u>REFERENCE DATES</u>											
Peak	Trough	Employment				Real GDP				Personal Income			
		Peak	Trough	% Change	Rank	Peak	Trough	% Change	Rank	Peak	Trough	% Change	Rank
November 1948(IV)	October 1949 (IV)	45,294.0	42,950.0	-5.2%	2	1,869.8	1,840.3	-1.6%	7	1,360.6	1,320.0	-3.0%	3
July 1953(II)	May 1954 (II)	50,536.0	48,825.0	-3.4%	4	2,368.2	2,305.5	-2.6%	5	1,701.0	1,661.5	-2.3%	5
August 1957(III)	April 1958 (II)	53,128.0	50,912.0	-4.2%	3	2,618.9	2,521.2	-3.7%	1	1,935.9	1,887.9	-2.5%	4
April 1960(II)	February 1961 (I)	54,812.0	53,556.0	-2.3%	7	2,834.4	2,819.3	-0.5%	11	2,077.9	2,070.4	-0.4%	9
December 1969(IV)	November 1970 (IV)	71,240.0	70,409.0	-1.2%	11	4,283.4	4,256.6	-0.6%	10	3,214.3	3,247.7	1.0%	11
November 1973(IV)	March 1975 (I)	78,634.0	76,649.0	-2.5%	6	4,953.1	4,795.3	-3.2%	2	3,773.8	3,588.6	-4.9%	2
January 1980(I)	July 1980 (III)	90,991.0	89,832.0	-1.3%	10	5,908.5	5,776.6	-2.2%	3	4,366.9	4,291.6	-1.7%	7
July 1981(III)	November 1982 (IV)	91,594.0	88,756.0	-3.1%	5	6,030.2	5,866.4	-2.7%	2	4,510.9	4,497.3	-0.3%	10
July 1990(III)	March 1991(I)	109,817.0	108,196.0	-1.5%	9	8,059.6	7,950.2	-1.4%	6	5,919.6	5,814.0	-1.8%	6
March 2001(I)	November 2001 (IV)	132,530.0	130,328.0	-1.7%	8	11,334.5	11,340.1	0.0%	6	8,458.5	8,381.1	-0.9%	8
December 2007 (IV)	October 2009 (III)	137,951.0	129,633.0	-6.0%	1	13,391.2	12,901.5	-3.7%	1	9,671.1	8,998.3	-7.0%	1
Average for Post WWII				-2.9%				-2.0%				-2.2%	
Exigent Factor				-3.1%				-1.6%				-4.8%	
Degree of decline due to exigency				51.4%				44.8%				69.0%	
Weighted Average (30% Employment, 50% GDP, and 20% Personal Income)								51.6%					
Average for Post 1970				-2.5%				-2.0%				-2.2%	
Exigent Factor				-3.6%				-1.7%				-4.7%	
Degree of decline due to exigency				59.2%				46.4%				68.1%	
Weighted Average (30% Employment, 50% GDP, and 20% Personal Income)								54.6%					

Sources: National Bureau of Economic Research (NBER); Bureau of Labor Statistics (BLS); Bureau of Economic Analysis (BEA).

For mail volume declines associated with recessions generally over the short-run, one would therefore expect that changes in GDP would be the best measure, employment the second best and personal income the third best. The extent percentage of the 2008-2009 recession is measured using a weighted average of 50 percent, 30 percent and 20 percent for real GDP, payroll employment and personal income, respectively, for the post WW II data where the weights reflect the impact of the 2008-2009 recession on postal volume.

Appendix B

Differences Between General Rate Cases Under PAEA and the PRA

By comparison with pre-PAEA procedures for a postal rate case, this exigent rate case has many differences. First, there is no test year “break-even” requirement, indeed if there were, the statement of James M. Kiefer on behalf of the Postal Service has indicated it would be a 20 percent average price increase. Instead, the Postal Service is trying to achieve a TY2011 deficit target of \$4,713 million which it estimates would be \$6,984 before rates.³⁶

Second, the rate increases requested average about 5.6 percent, and are viewed as part of a balanced set of measures to restore a balance between USPS revenues and USPS costs. Third, the risk and uncertainty surrounding the fate of virtually all of these other measures renders it virtually impossible to assess with much confidence whether the requested rate increases are too much, too little, or as USPS presumes without proof just right on economic grounds. Fourth, as such, it is absolutely not possible for the Postal Service or the Postal Regulatory Commission to determine whether the rates proposed are “necessary”. In particular, under current circumstances especially, one could only know this in hindsight³⁷

Fifth, rate-making under the 1970 Postal Reorganization Act was largely cost-of-service ratemaking. Under PAEA, USPS has been granted greater pricing flexibility in response to market conditions, and in this sense under PAEA rate-making is much more demand-based. Mr. Kiefer states on page 8 of his statement: “This exigent price request is not structured as an across-the-board increase similar to the increase proposed in Docket No. R2005-1.” (R2010-4, Kiefer Statement, page 8 lines 10-11.) (It might be noted that the R2001-1 rate case was an across-the-board (ATB) case in response to the 9/11 and anthrax events.) Sixth, unlike rate cases under the 1970 PRA

³⁶ R2010-4, USPS, “Statement of James M. Kiefer on Behalf of the United States Postal Service”, page 5, lines 20-21.

³⁷ The statement of USPS CFO Joseph Corbett goes into the requirements of an “exigent” rate case on pages 10-20.

it is not clear in R2010-4 what the various rate increases are based on: Costs, demand, revenue-need, volume stimulus, incentives to grow volume, contribution levels, or other. In some sense the proposed rate increase seems based on all these factors and on none of them.³⁸

³⁸ It would appear that during prosperity in such a regulated industry demand-based rate-making is sound, but during recessions rate-making reverts back to cost-of-service.

Appendix C

Table C1 and Table C2

Mail Volume for Normal Part and Exigent Part of 2008-2009 Recession

Table C1

Mail Volume for Normal Part and Exigent Part of 2008-2009 Recession (35% Exigency)

	[1]	[2]	[3]	[4]	[5]	[6]	[7]	Normal Part of 2008-2009 Recession		Exigent Part of 2008-2009 Recession		[12]
								[8]	[9]	[10]	[11]	
Year	Internet Diversion in All USPS* Mail	Actual Mail Volume USPS*	Internet Diversion Forecast Based on 1997-2006 GCA	Internet Diversion Due to Recession [1]-[3]	Mail Volume Decline Due to Macro Factors USPS*	Total Mail Volume Decline Due to 2008- 2009 Recession [4]+[5]	Mail Volume Decline Due to 2008- 2009 Recession with No Recession [2]+(-[6])	Mail Volume Decline Due to an Average Post War Recession 0.65*[6] 65%	Mail Volume Decline Due to an Average Post War Recession [7]+[8]	Mail Volume Decline Due to Exigent Part of Recession 0.35*[6] 35%	Mail Volume for Exigent Part of Recession [7]+[10]	Base Year Volume Multiplier Factor for Exigent Part of Recession [11]/[2]
1988												
1989												
1990												
1991												
1992												
1993												
1994												
1995												
1996												
1997	(1,833.4)	188,712.4										
1998	(1,376.7)	195,539.0										
1999	(2,476.6)	200,442.8										
2000	(3,009.1)	207,835.7										
2001	(2,213.8)	207,452.6										
2002	(2,252.7)	202,819.1										
2003	(2,444.4)	202,181.8										
2004	(2,501.2)	206,095.8										
2005	(3,081.4)	211,682.8										
2006	(3,492.8)	212,980.8										
2007	(4,236.0)	212,234.0	(3,312.7)									
2008	(4,155.5)	202,704.1	(3,466.3)	(689.2)	(12,402.5)	(13,091.7)	215,795.8	(8,509.6)	207,286.2	(4,582.1)	211,213.7	1.042
2009	(4,111.0)	177,057.6	(3,619.8)	(491.2)	(21,685.4)	(22,176.6)	199,234.2	(14,414.8)	184,819.4	(7,761.8)	191,472.4	1.0814

Source: * Values for Internet diversion in all mail, actual mail volume, and mail volume due to macro factors are obtained from GCA.1.Sources-of-Change.xls excel file provided by USPS in response to the interrogatories of GCA, filed on May 3, 2010, N2010-1, GCA/USPS-T2-1-2(A), redirected from witness Corbett.

Note: The mail volume decline due to macro factors shown in column [6] approximates the decline in mail volume due to recession

Table C2

Mail Volume for Normal Part and Exigent Part of 2008-2009 Recession (45% Exigency)

Year	[1]	[2]	[3]	[4]	[5]	[6]	[7]	Normal Part of 2008-2009 Recession		Exigent Part of 2008-2009 Recession		Base Year Volume Multiplier Factor for Exigent Part of Recession
	Internet Diversion in All Mail USPS*	Actual Mail Volume USPS*	Internet Diversion Forecast Based on 1997-2006 GCA	Internet Diversion Due to Recession [1]-[3]	Mail Volume Decline Due to Macro Factors USPS*	Total Mail Volume Decline Due to 2008- 2009 Recession [4]+[5]	Mail Volume Decline Due to 2008- 2009 Recession with No Post War Recession [2]+(-[6])	Mail Volume Decline Due to an Average Post War Recession 0.55*[6] 55%	Mail Volume for an Average Post War Recession [7]+[8]	Mail Volume Decline Due to Exigent Part of Recession 0.45*[6] 45%	Mail Volume for Exigent Part of Recession [7]+[10]	
1988												
1989												
1990												
1991												
1992												
1993												
1994												
1995												
1996												
1997	(1,833.4)	188,712.4										
1998	(1,376.7)	195,539.0										
1999	(2,476.6)	200,442.8										
2000	(3,009.1)	207,835.7										
2001	(2,213.8)	207,452.6										
2002	(2,252.7)	202,819.1										
2003	(2,444.4)	202,181.8										
2004	(2,501.2)	206,095.8										
2005	(3,081.4)	211,682.8										
2006	(3,492.8)	212,980.8										
2007	(4,236.0)	212,234.0	(3,312.7)									
2008	(4,155.5)	202,704.1	(3,466.3)	(689.2)	(12,402.5)	(13,091.7)	215,795.8	(7,200.4)	208,595.4	(5,891.3)	209,904.5	1.036
2009	(4,111.0)	177,057.6	(3,619.8)	(491.2)	(21,685.4)	(22,176.6)	199,234.2	(12,197.1)	187,037.1	(9,979.5)	189,254.7	1.0689

Source: * Values for Internet diversion in all mail, actual mail volume, and mail volume due to macro factors are obtained from GCA.1.Sources-of-Change.xls excel file provided by USPS in response to the interrogatories of GCA, filed on May 3, 2010, N2010-1, GCA/USPS-T2-1-2(A), redirected from witness Corbett.

Note: The mail volume decline due to macro factors shown in column [6] approximates the decline in mail volume due to recession

Appendix D

Methodology for Forecasting Volume & Revenue and Estimating Attributable Cost & Deficit for Exigent Part of 2008-2009 Recession

- 1) Volume and Revenue Forecast for Exigent Part of 2008-2009 Recession:**
 - a. From the "Market Dominant Forecasts" folder in the library reference, USPS-R2010-4/8, "Revenue and Volume Forecast Materials (Public Version)" obtain "vf-Jan'11 implementation md.xls" and "After-Rates Jan11 V&R Forecast Public.xls" excel files.
 - b. For the After-Rates volume and revenue forecast, the BY volume is increased by 8.14 percent or 6.89 percent in the worksheet "Forecast Vols" in the "vf-Jan'11 implementation md.xls" excel file by multiplying the given quarterly BY volumes (quarters 2009.2, 2009.3, 2009.4, and 2010.1) by 1.0814 or 1.0689.
 - c. The volume and revenue forecast are then obtained from "Volume Forecast" and "Revenue Forecast" worksheets in "After-Rates Jan11 V&R Forecast Public.xls" excel file.

Note: Our calculated volumes and revenues using the USPS supplied excel files may be different than Masse due to the fee differences and certain categories not reported in Masse. Therefore, the revenue and volumes are approximates.

- 2) Attributable Cost Estimation for Exigent Part of Recession:**

The FY2011 After Rates attributable cost estimates for exigent part of 2008-2009 recession shown below in Table D1 and Table D2 are obtained as follows.

- a. In Table D1, subpart Table D1-a, USPS before and after rates volumes and attributable costs are used to find the relationship between volume and attributable cost. Based on these calculations, a 0.38 percent drop in attributable cost is found to be associated with a 0.76 percent drop in volume. In other

words, the percentage drop in attributable cost is almost half (0.49) of percentage drop in volume.

- b. In the subpart, Table D1-b, this relationship between the attributable cost and volume is applied to estimate attributable costs for FY2011 After Rates by assuming that BY volume would have been 8.14 percent higher for exigent part of recession. For example, in subpart Table D1-b, for the exigent part of the recession, it can be seen that volume for FY2011 After Rates would have been higher by 8.1 percent $[(186,964-172988)/172988]$ compared to USPS volume. Multiplying 8.1 percent by 0.49 (from Table D1-a) yields 4 percent, which is the percentage that the attributable cost for FY2011 After Rates with 8.14 percent rise in BY volume is higher than attributable cost for FY2011 After Rates with no change in BY volume. Therefore, the attributable cost for FY2011 After Rates with 8.14 percent higher BY Volume will be \$77,493 ($\$74,524 * 1.04$).
- c. Subpart Table D1-c shows the estimated revenue and attributable cost as well as deficit for the FY2011 After Rates assuming 8.14 percent higher BY volume (first row) and the USPS' corresponding values (second row). The calculations show a lower deficit (\$3,085 million) for FY2011 After Rates with 8.14 percent higher BY volume compared to the USPS estimated deficit (\$4,868 million), a drop in deficit of \$1,783 million.
- d. Subpart Table D1-d shows the amount that revenue should become by lowering the rates in order for the USPS to achieve a neutral deficit target.
- e. Subpart Table D1-e shows the USPS rate increases and the maximum lawful rate increases overall and the Single Piece Letters. For example, the maximum lawful percentage rate increase for the exigent part of the recession is 3.55 percent ($\$3,086 / \$4,868 * 5.6\%$) and the percentage rate increase for Single Piece Letters is 2.95 percent ($4.65\% / 5.6\% * 3.55\%$) with the corresponding rate of 45.297 cents ($44 * 1.0295$).
- f. Parts (a) to (e) were applied to Table D2 for the case that the BY volume is higher by 6.89 percent.

Table D1

Allowable Average Rates Increase with Thirty Five Percent Exigent Factor

Table D1-a

Volume and Attributable Cost with No Change in Base Year Volume (millions)

	Volume	Attributable Cost	Cost/Volume
FY2011 Before Rates (USPS)	174,316	\$74,805	
FY2011 After Rates (USPS)	172,988	\$74,524	
% Change	-0.76%	-0.38%	0.49

Note: Based on the above numbers, when volume drops by certain percentage, attributable cost percentage drop is almost half (0.49) of volume percentage drop. This relationship will be used in Table b and c to estimate attributable cost.

Table D1-b

FY2011 After Rates Volume and Attributable Cost (millions)

	Volume	Attributable Cost
FY2011 After Rates with 8.14% rise in BY volume (GCA)	186,964	\$77,493
FY2011 After Rates with no Change in BY Volume (USPS)	172,988	\$74,524
% Change	8.1%	4.0%

Table D1-c

FY2011 After Rates Deficit for Exigent Part of Recession (millions)

	Revenue	Attributable Cost	Deficit
FY2011 After Rates with 8.14% rise in BY volume (GCA)	\$74,408	\$77,493	-\$3,085
FY2011 After Rates with no Change in BY volume (USPS)	\$69,656	\$74,524	-\$4,868
Reduction in Deficit			\$1,783

Table D1-d

FY2011 After Rates Deficit Revenue Neutral Deficit for Exigent Part of Recession (millions)

	Revenue	Attributable Cost	Deficit
FY2011 After Rates with 8.14% rise in BY volume (GCA)	\$72,625	\$77,493	-\$4,868
FY2011 After Rates with no Change in BY volume (USPS)	\$69,656	\$74,524	-\$4,868
Reduction in Deficit			\$0

Note: GCA estimated After-Rates revenue has to drop by 2.4% from \$74,408 to \$72,625 to achieve a neutral deficit target with lower rates.

Table D1-e

FY2011 USPS Proposed and Maximum Lawful Rate Increases and for SP letters

USPS Proposed Overall % Rate Increase	5.6%
Maximum Lawful Overall % Rate Increase for Exigent Part of Recession	3.55%
USPS Proposed Overall % Rate Increase	5.60%
USPS Proposed % Rate Increase for Single Piece Letters	4.65%
Maximum Lawful % Rate Increase for Single Piece Letters	2.95%
USPS Current Rate for Single Piece Letters (cents)	44.0
Maximum Lawful Rate for Single Piece Letters (cents)	45.297

Sources:

* The USPS FY2011 Before Rates and After Rates values are obtained from "Masse strmt Attachments 1 to 12.xls" excel file.

Table D2

Allowable Average Rates Increase with Forty Five Percent Exigent Factor

Table D2-a

Volume and Attributable Cost with No Change in Base Year Volume (millions)

	Volume	Attributable Cost	Cost/Volume
FY2011 Before Rates (USPS)	174,316	\$74,805	
FY2011 After Rates (USPS)	172,988	\$74,524	
% Change	-0.76%	-0.38%	0.49

Note: Based on the above numbers, when volume drops by certain percentage, attributable cost percentage drop is almost half (0.49) of volume percentage drop. This relationship will be used in Table b and c to estimate attributable cost.

Table D2-b

FY2011 After Rates Volume and Attributable Cost (millions)

	Volume	Attributable Cost
FY2011 After Rates with 6.89% rise in BY volume (GCA)	184,814	\$77,036
FY2011 After Rates with no Change in BY Volume (USPS)	172,988	\$74,524
% Change	6.8%	3.4%

Table D2-c

FY2011 After Rates Deficit for Exigent Part of Recession (millions)

	Revenue	Attributable Cost	Deficit
FY2011 After Rates with 6.89%% rise in BY volume (GCA)	\$73,701	\$77,036	-\$3,335
FY2011 After Rates with no Change in BY volume (USPS)	\$69,656	\$74,524	-\$4,868
Reduction in Deficit			\$1,533

Table D2-d

FY2011 After Rates Deficit Revenue Neutral Deficit for Exigent Part of Recession (millions)

	Revenue	Attributable Cost	Deficit
FY2011 Before Rates with 6.89% rise in BY volume (GCA)	\$72,168	\$77,036	-\$4,868
FY2011 Before Rates with no Change in BY volume (USPS)	\$69,656	\$74,524	-\$4,868
Reduction in Deficit			\$0

Note: GCA estimated After-Rates revenue has to drop by 2.1% from \$73,701 to \$72,168 to achieve a neutral deficit target with lower rates.

Table D2-e

FY2011 USPS Proposed and Maximum Lawful Rate Increases Overall and for SP letters

USPS Proposed % Rate Increase	5.6%
Maximum Lawful % Rate Increase for Exigent Part of Recession	3.84%
USPS Proposed Overall % Rate Increase	5.60%
USPS Proposed % Rate Increase for Single Piece Letters	4.65%
Maximum Lawful % Rate Increase for Single Piece Letters	3.19%
USPS Current Rate for Single Piece Letters (cents)	44.0
Maximum Lawful Rate for Single Piece Letters (cents)	45.402

Sources:

* The USPS FY2011 Before Rates and After Rates values are obtained from "Masse stmt Attachments 1 to 12.xls" excel file.

Appendix E

Other Materials

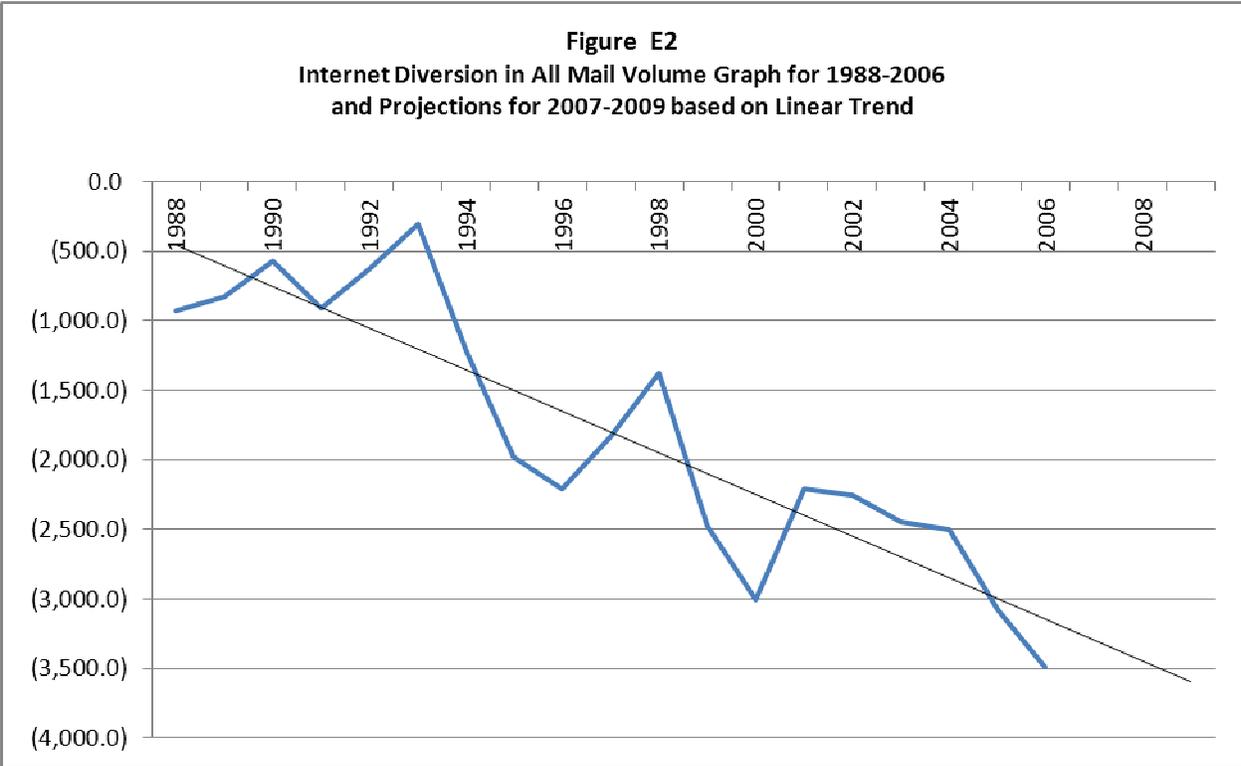
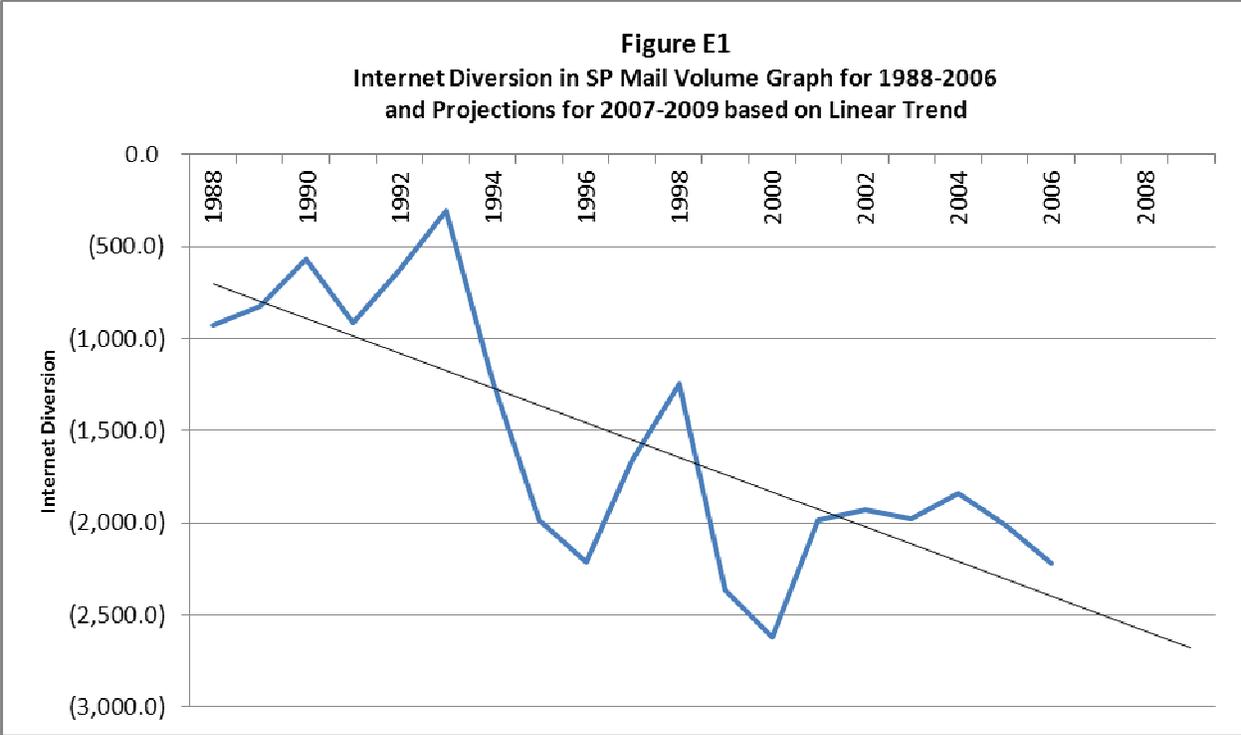


Table E1

U.S. Business Cycle Expansions and Contractions Since the Postal Reform Act (PRA)

<u>BUSINESS CYCLE</u>		<u>DURATION IN MONTHS</u>			
<u>REFERENCE DATES</u>		<u>Contraction</u>	<u>Expansion</u>	<u>Cycle</u>	
Peak	Trough	<i>Peak</i>	<i>Previous</i>	<i>Trough</i>	<i>Peak</i>
<i>Quarterly dates</i>			<i>trough</i>	<i>from</i>	<i>from</i>
<i>are in parentheses</i>		<i>to</i>	<i>to</i>	<i>Previous</i>	<i>Previous</i>
		<i>Trough</i>	<i>this peak</i>	<i>Trough</i>	<i>Peak</i>
December 1969(IV)	November 1970 (IV)	11	106	117	116
November 1973(IV)	March 1975 (I)	16	36	52	47
January 1980(I)	July 1980 (III)	6	58	64	74
July 1981(III)	November 1982 (IV)	16	12	28	18
July 1990(III)	March 1991(I)	8	92	100	108
March 2001(I)	November 2001 (IV)	8	120	128	128
December 2007 (IV)			73		81
Average, all cycles since 1969:		10.8	70.7	81.5	81.8

Source: National Bureau of Economic Research, Inc.