POSTAL PRICE CAP REGULATION:
UNITED STATES EXPERIENCE SINCE 2006

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Caveat

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Price Cap in the economic literature

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

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

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

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

Market Dominant Products Regulatory system
  - 9 Objectives, 14 Factors
  - Other provisions of Title 39 including § 101.

Driver: Regular and predictable rates

Transparency and Accountability

Limited time for rate review

Hallmark of the law: a price cap
PAEA Features - MD

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

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

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

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

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

- Mailer - initiated: Outcome of a formal complaint proceeding (potential)
PAEA Implementation of Price Cap

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

- Loss Making (“Underwater”) Products
- Changes to Mail Preparation Requirements
- Quality of Service Adjustments
Technical/Calculation Issues - 1

- Moving Average vs Point to Point
- Timing Flexibility for Price Adjustments
- Unused Rate Authority
- Deflationary Periods
Technical/Calculation Issues - 2

- Selection of a Price Index
- Incentives and Promotional Rates
- Rebates
- Rate Decreases
- New Mail Classes or Class Changes
The PAEA Ten Year Review

- Required to determine if the system is achieving
  - The Objectives of the Act
  - Taking into account the Factors in the Act
- PRC has broad discretion to conduct the Review
- If the PRC determines the system is not achieving…
- It can make modifications to the system or adopt an alternative system
- Wide range of potential courses of action
Conclusions - 1

- PAEA price cap has increased predictability of rates, incented cost reduction and productivity, and substantially reduced the cost and duration of rate proceedings.

- While the price cap system is simple in theory, in practice the interplay of price cap features can create ambiguity and uncertainty and has required clarification.
Conclusions - 2

- Quality of Service can be under pressure and merits particular attention in a price cap regime.

- Cost shifting from the operator to customers may be perceived by customers as a means of evading the price cap.
Conclusions - 3

- Establishing a price cap regulatory system without first properly restructuring rates to recover all costs, to align rates with costs and to match current market demands can be problematic.

- Periodic revisiting/reset of the price cap mechanism may provide benefits.

- Any renegotiated price cap regime should include an evaluation of revenue requirements and external factors that may impact the initial ability to produce a net surplus (or break even), service debt and satisfy the USO.
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