

# Postal Regulation in a Time of Change

Summary of the Postal Regulatory  
Commission's Review of the Ratemaking  
System

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# Overview of Presentation

- ▶ What is the Postal Regulatory Commission?
- ▶ Issues with Prior Ratemaking System
- ▶ PAEA
- ▶ Review of Ratemaking System
  - ▶ Ratemaking structure
  - ▶ Financial Condition
  - ▶ Service Quality
- ▶ Regulatory Impacts of Commission Findings

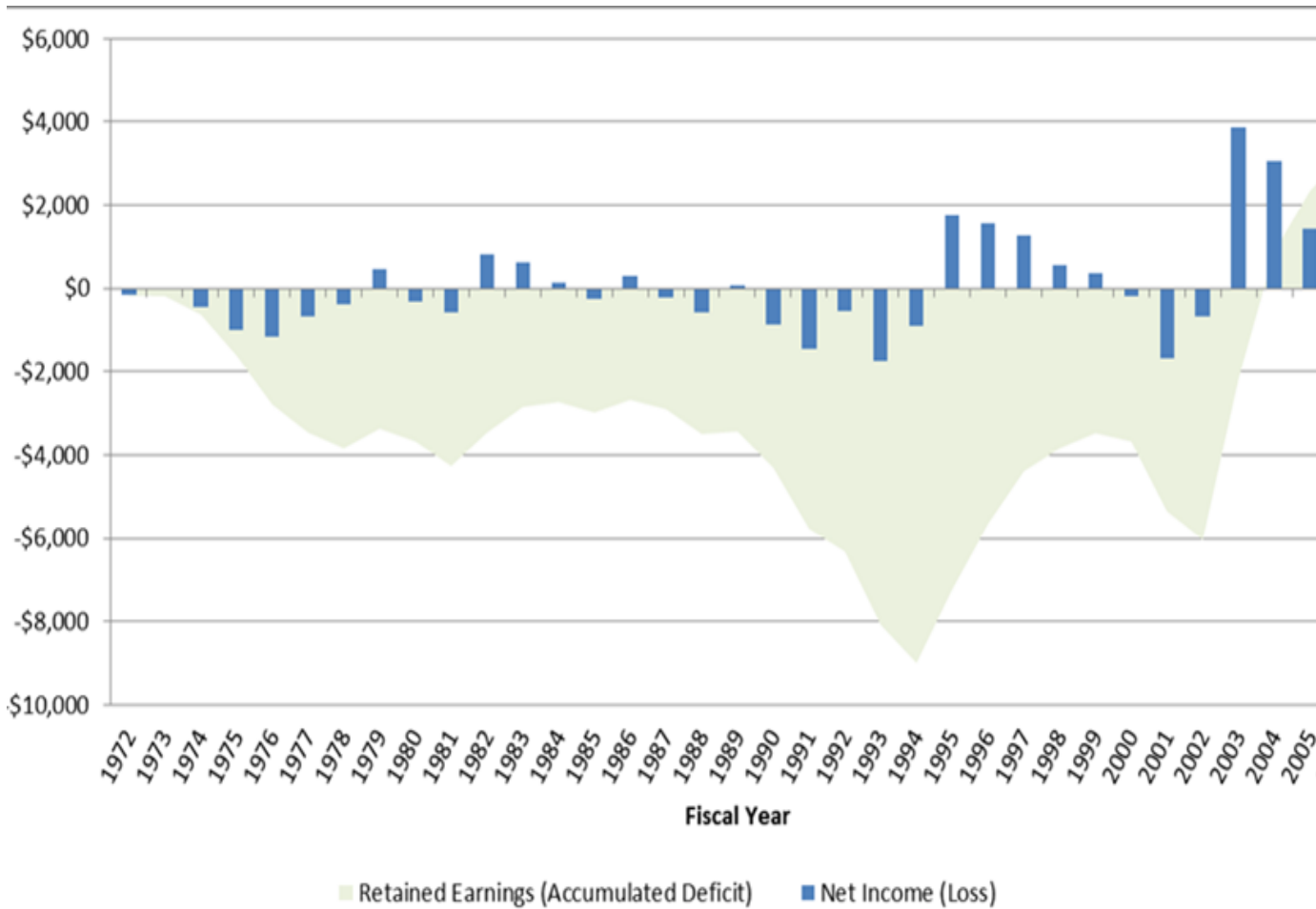
# What is the Postal Regulatory Commission?

- ▶ Regulator of the U.S. Postal Service only
- ▶ Five Commissioners
- ▶ Role of the Commission
  - ▶ Develop and implement a modern system of rate regulation
  - ▶ Provide annual compliance reviews on the U.S. Postal Service's finances and operations and Annual Report to Congress on Commission's activities
  - ▶ Adjudicate complaints
  - ▶ Provide advisory opinions on nationwide changes to service

# Issues with Prior Ratemaking System

- ▶ Cost-of-service model with a break-even mandate
- ▶ Rate adjustment proceedings were time consuming and expensive
- ▶ Commission recommended rates that often differed from the rates proposed by the Postal Service
- ▶ Postal Service had little incentive to cut costs
- ▶ No mechanism for sustained net income or retained earnings

# Finances Under PRA System



# Postal Accountability and Enhancement Act of 2006

- ▶ Price cap system pegged to inflation
- ▶ Designed to:
  - ▶ Allow USPS to earn and retain profits
  - ▶ Provide USPS flexibility to compete and innovate
  - ▶ Provide greater transparency and accountability in the postal system
  - ▶ Provide predictability and stability in rates
- ▶ Set ceiling on worksharing discounts

# Review of Ratemaking System

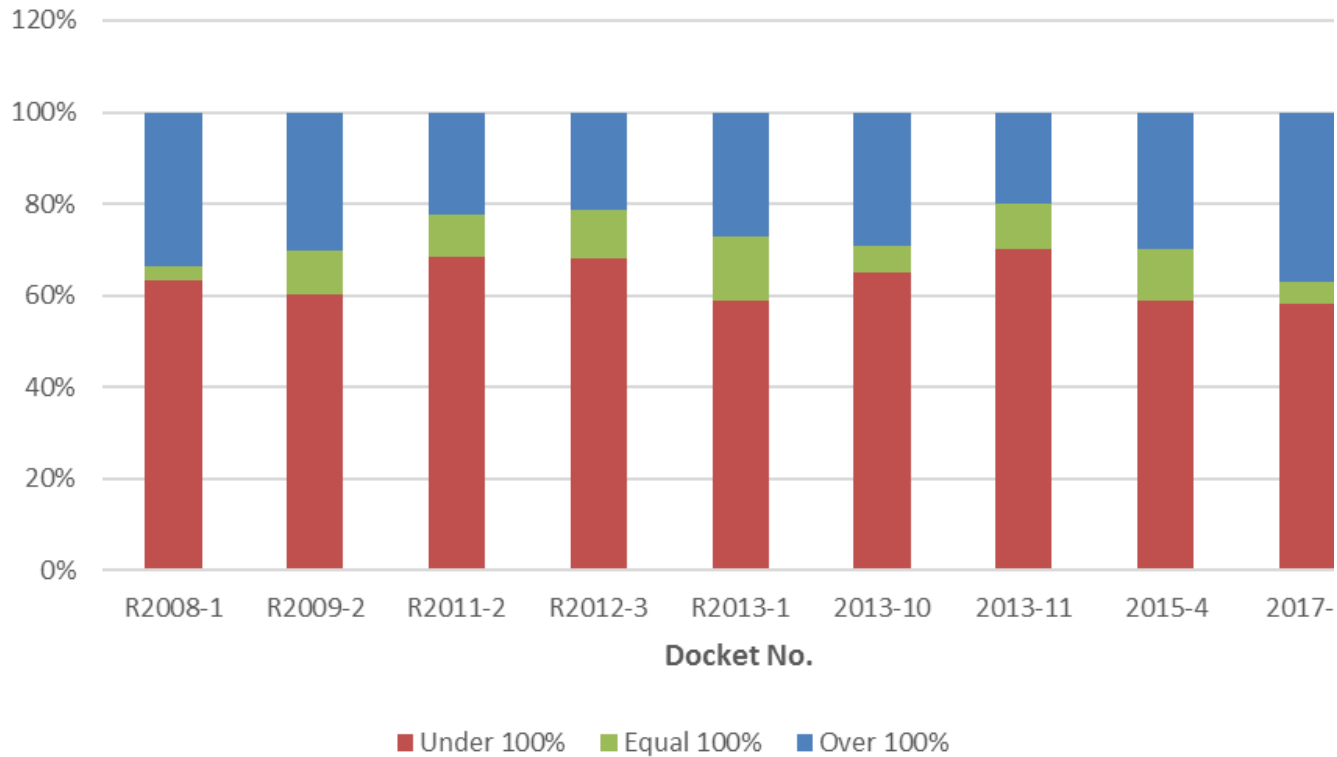
- ▶ Congress required review of the ratemaking system ten years after passage of the PAEA
  - ▶ Determine if objectives are being met
  - ▶ Alterations if necessary
- ▶ Commission identified three topical areas which captured all nine objectives
  - ▶ Structure of the ratemaking system
  - ▶ Financial health of the Postal Service
  - ▶ Service quality

# Structure of the Ratemaking System

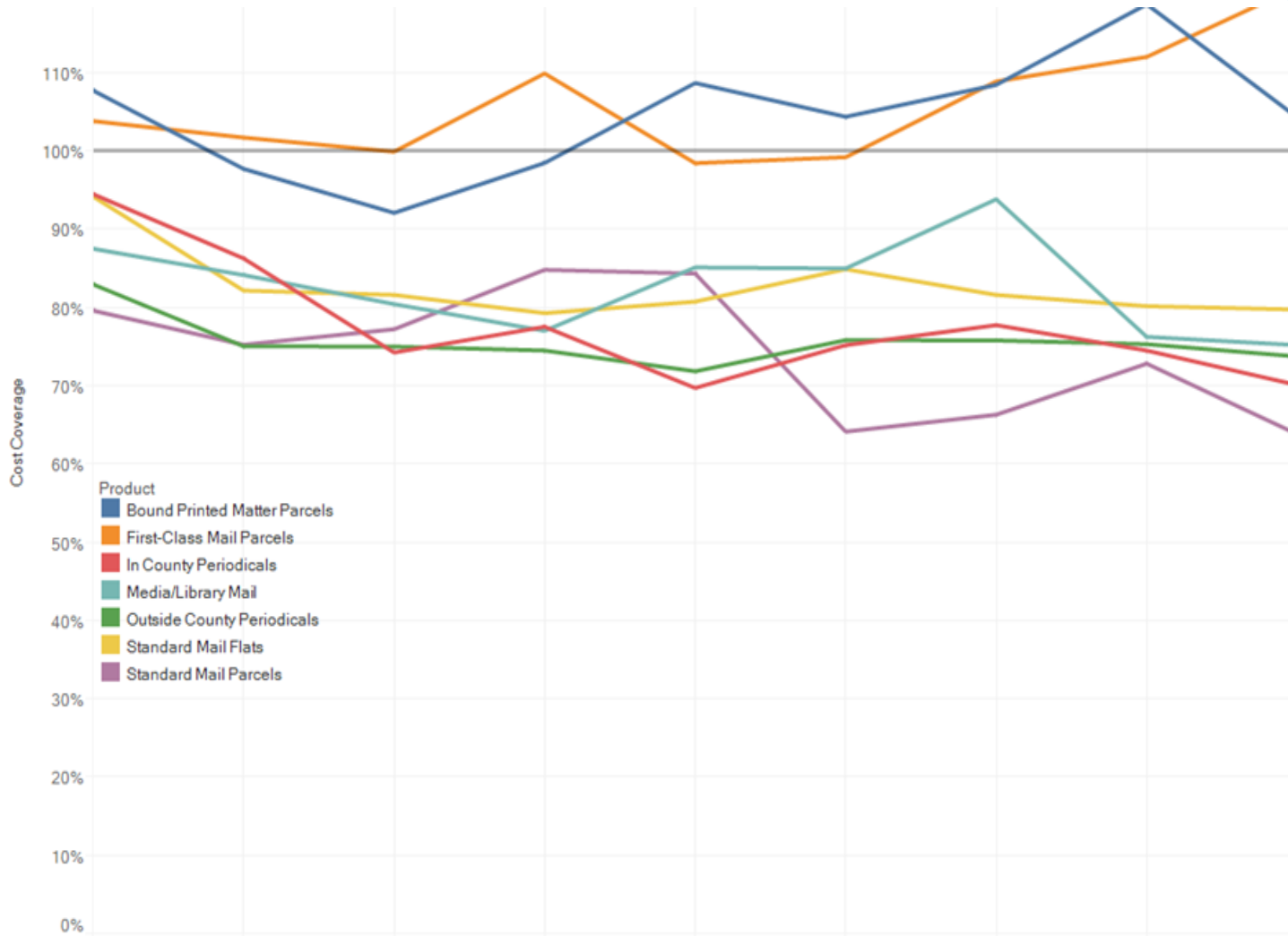
- ▶ System worked as intended:
  - ▶ to create rate adjustments that are stable and predictable
  - ▶ reduce the administrative burden and increase the transparency of the ratemaking system
  - ▶ and provide the Postal Service pricing flexibility while maintaining just prices
- ▶ Has not increased pricing efficiency



# Efficient Component Pricing Workshare Discount Passthroughs



# Allocative Efficiency



# Financial Health of the Postal Service

- ▶ System has not maintained the financial health of the Postal Service as intended by the 2006 Law.
  - ▶ Short-term generally met
  - ▶ Both medium-term and long-term financial stability measures have not been achieved
    - ▶ Total revenue not sufficient to cover total costs
    - ▶ No retained earnings

# Financial Results after PAEA

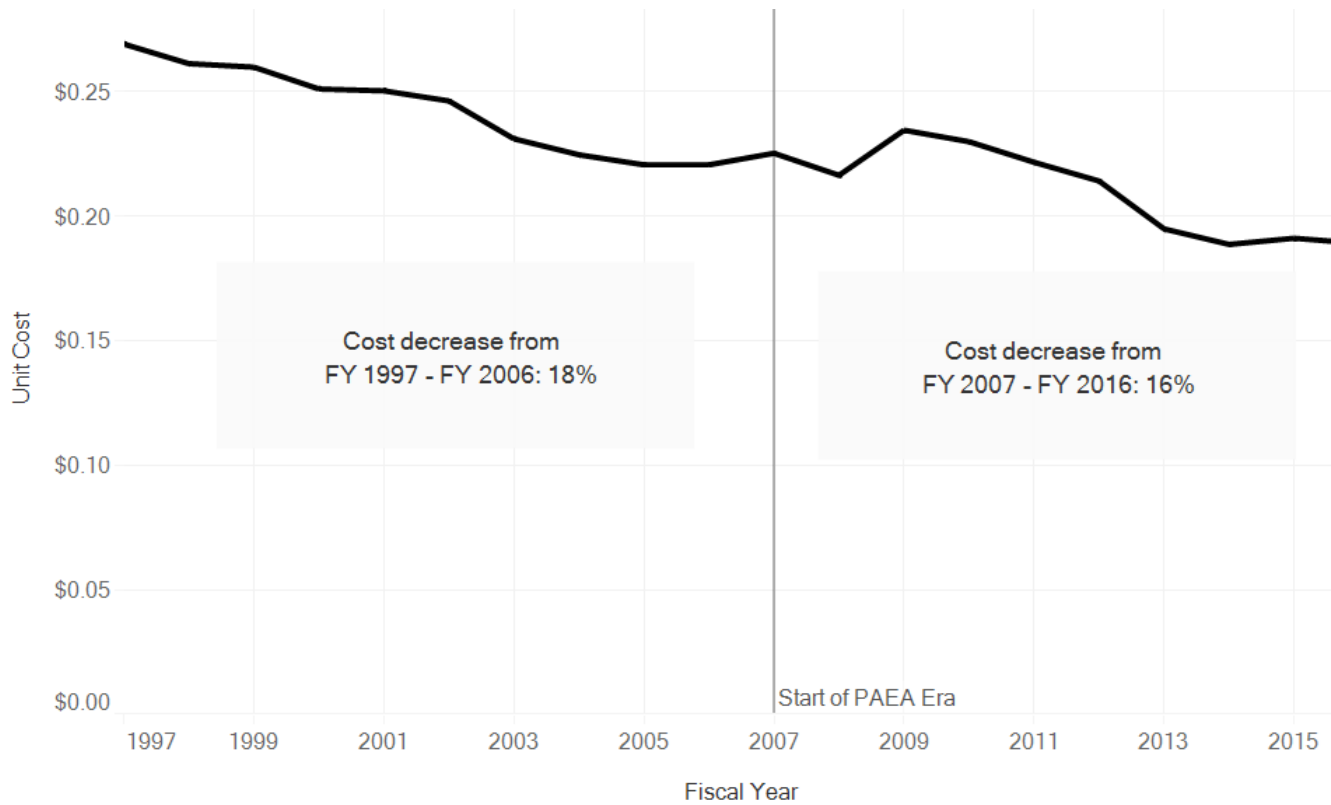
Dollars in Billions

Fiscal Year	Net Income (Loss)	Retained Earnings (Accum. Deficit)
2006		3.2
2007	(5.1)	(1.9)
2008	(2.8)	(4.7)
2009	(3.8)	(8.5)
2010	(8.5)	(17.0)
2011	(5.1)	(22.1)
2012	(15.9)	(38.0)
2013	(5.0)	(43.0)
2014	(5.5)	(48.5)
2015	(5.1)	(53.6)
2016	(5.6)	(59.2)

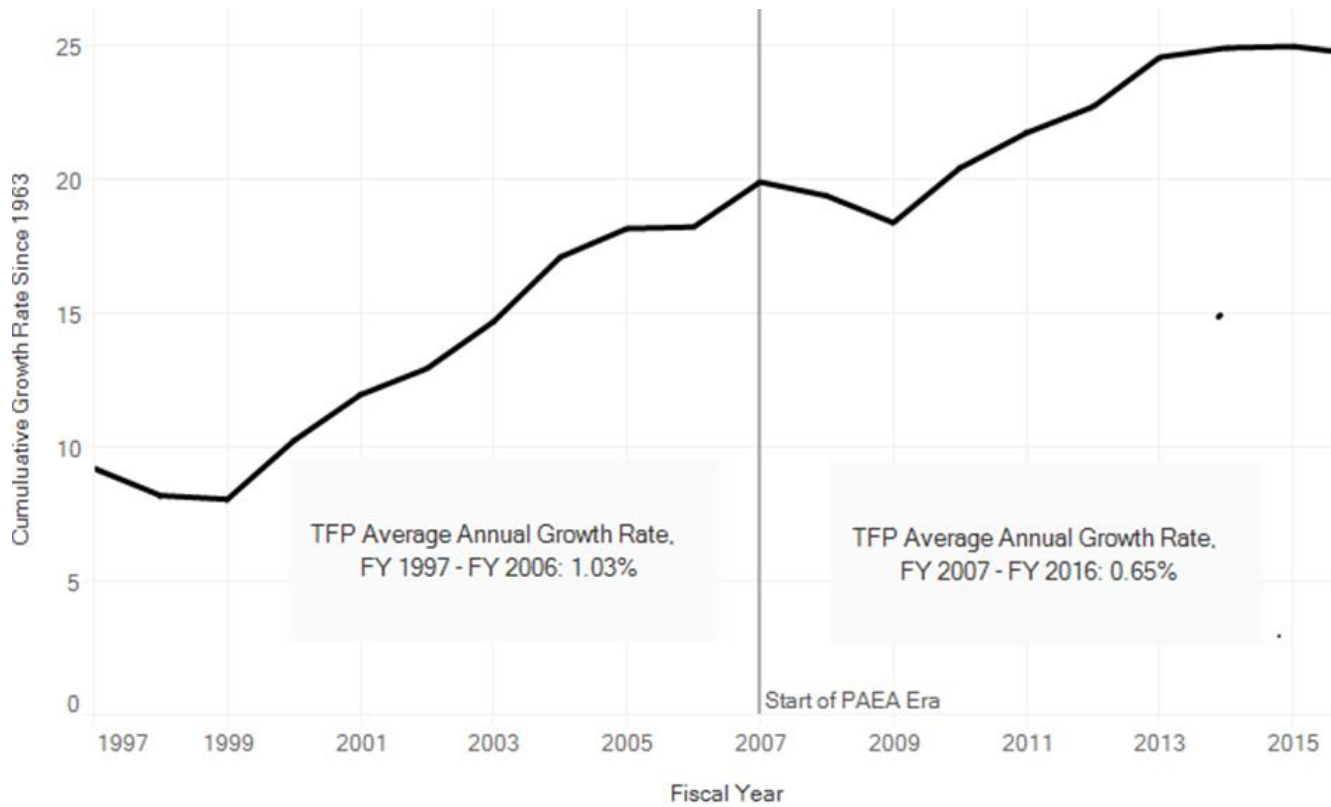
# Financial Health of the Postal Service

- ▶ Some cost reductions and efficiency gains occurred during the past 10 years
- ▶ Incentives were not maximized in a way that allowed the Postal Service to achieve financial stability.

# Cost Reductions



# Efficiency Gains



# Financial Health of the Postal Service

- ▶ System did not maintain reasonable rates



## Non-compensatory Products

	First	Period.	Std.	Pack.	Total
2008	(102)	(438)	(393)	(126)	(1,059)
2009	(105)	(642)	(821)	(142)	(1,710)
2010	(53)	(611)	(749)	(250)	(1,663)
2011	(33)	(609)	(755)	(190)	(1,587)
2012	(103)	(670)	(577)	(122)	(1,472)
2013	(98)	(521)	(411)	(79)	(1,109)
2014	(54)	(508)	(442)	(20)	(1,024)
2015	(75)	(512)	(544)	(85)	(1,216)
2016	(28)	(530)	(633)	(88)	(1,279)
Total	(651)	(5,041)	(5,325)	(1,102)	(12,119)

# Service Performance

- ▶ High quality service standards have not been maintained during the past 10 years.
- ▶ The system does not effectively encourage the Postal Service to maintain service standard quality.

# Regulatory Impacts (Proposed Rules)

- ▶ Build upon the CPI price cap by providing discrete amounts of additional rate authority
  - ▶ Supplemental rate authority
  - ▶ Performance based rate authority
- ▶ Requirements for non-compensatory products
- ▶ Workshare passthrough bands

# Supplemental Rate Authority

- ▶ 2 percentage points of supplemental rate authority, in addition to the CPI price cap,
- ▶ Annually for a 5-year period.
  - ▶ After five years, the supplemental rate authority will terminate and the Commission will review the Postal Service's financial condition.

# Performance-based Rate Authority

- ▶ 1 percentage point of performance-based rate authority, per calendar year
  - ▶ Path to long-term financial stability
  - ▶ provide meaningful incentives for the Postal Service to increase operational efficiency and maintain high quality service standards
    - ▶ 0.75 percentage points is allocated based on meeting operational efficiency-based requirements
    - ▶ 0.25 percentage points is allocated based on maintaining service quality.
  - ▶ Postal service only receives this additional performance based rate authority if it meets certain efficiency and service measures.

# Non-Compensatory Products

- ▶ Whenever the Postal Service files a request for the Commission to review a notice of rate adjustment applicable to any class of mail, it will be required to propose to increase the rate for any non-compensatory product within that class by a minimum of 2 percentage points above the percentage increase for the class.
- ▶ For non-compensatory classes, an additional 2% authorized

# Workshare Discounts

- ▶ Workshare Passthrough Bands - one for Periodicals, and one for all other classes.
  - ▶ For periodicals, pass-through must range between 75 percent and 125 percent.
  - ▶ Everything else, pass-through must range between 85 percent and 115 percent.
- ▶ 3-year grace period