

Lessons learned from USPS's requests for prices increases to offset Inflation

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Agenda

- The Objective of the paper
- Regulatory Background
- Effects of Inflation
- International Comparisons
- Lessons learned and Conclusion

The Objective of the paper



- The inflation rate in 2022 was more than 9%, highest rate since 1982
- This spike occurred a few months before Postal Service Reform Act and one year after “Delivering for America 10 year-plan”
- We address 2 USPS’s rate increases: 1) in mail and packages, 2) in parcels to its competitors
- We compare the USP’s responses to international postal operators facing similar inflation rates

We will share the Lessons we have learned



Regulatory Background 1/2

- The 39 Code of Federal Regulations §3030 establishes the ratemaking for regulated market-dominant mail products
- **The market-dominant category:** First-Class Mail; Marketing Mail; Periodicals; Package Services, such as Library Mail; and Extra Services, (e.g. Certified Mail). Dominant categories are subject to price caps
 - The Price caps for dominant services have five components that apply to all rate categories
 - The five components set the ceiling on rate changes
- **The competitive category:** Priority Mail, Priority Mail Express and commercial package services, such as Parcel Select. Competitive products must cover attributable costs

Regulatory Background 2/2

The five components of price caps (maximum rate authority is the sum of the five components):

- 1- CPI-Urban unadjusted for seasonal variation over the most recently available 12-month period preceding the USPS's request
- 2- Banked rate authority (accumulated unused rate adjustment)
- 3- Density rate authority (decreases in density of mail)
- 4-Retirement obligation rate authority (amortization payments for unfunded liabilities)
- 5-Rate authority applicable to non-compensatory classes (revenue for a product insufficient to cover attributable costs)

Effects of Inflation 1/2



- Price caps assume the company has control over costs and has an incentive to reduce them...
- but an uncontrollable factor is unanticipated inflation: 9.1% increase CPI-U in 2022 well above the USPS's forecast of 3.9%
- On April 6, 2022, USPS filed notice of its planned price adjustments and related mail classification changes for Market Dominant products...
- In response to persistent inflation on Oct 7, 2022, USPS filed for another rate increase for Market Dominant Services (effective on Jan 22, 2023)
- On Jan. 22 USPS filed to raise prices for competitive prices

Effects of Inflation 2/2



USPS's Internal Challenges in the Face of Inflation:

- 1- There is a lag between announced price increases and CPI
 - Note: The reduction in allocated institutional costs that preceded the jump in inflation could have reduced USPS's need to raise prices for competitive services but could have put pressure on dominant services
- 2- Long-term funding uncertainty. USPS's liabilities are sensitive to changes in interest rates and medical cost likewise worker compensation

Inflation introduces volatility in future retirement obligations & product contracts. Fixed contracts create a lag effect between announced price changes and inflation rates.

These risks and lags reduce the signaling efficacy of price caps

International Benchmark- EU and UK 1/2



- From a recent report from Cullen out of the **17 largest postal markets in Europe** in 9 of them there is no price cap.
- Of the remaining, 7 of them include inflation rates as one of the main elements of price cap formulas, in 6 -- volumes, in 3 -- efficiency factors, in 3 -- the evolution of costs and in 1 -- the changes of the turnover of the incumbent. It is interesting to emphasize that demand elasticity is not considered in price cap formulas.
- We analyzed how inflation and changes in stamp prices were implemented in countries without a price cap (Spain, Austria) versus countries where there is a price cap linked to inflation (UK)

International Benchmark- EU and UK 1/2



We found:

- In countries **with or without price caps** that the surprise in inflation led to **delayed price responses in the postal industry**. The catchup among postal services under price cap regulation does not appear very different from those with more pricing flexibility
- The fact that in Spain (**without price cap**) and somehow to **a lesser extent** in the UK (**with a price cap**) a smoother and more **fine-tuned process has been put in place covering multiple years**... this might be interesting to scrutinize further in future research

Lessons learned and Conclusion

- Our basic observation is that unanticipated inflation creates uncertainty that makes planning difficult -- not surprising
- Price caps add a constraint to the planning process that produces a delayed response to inflation but did not seem to be a constraint -- surprising



In Uncertain times, planning is difficult with Price Caps...should we rethink (exceptions, e.g.unexpected inflation) the filing process?