

Price Caps and the US Postal Service

Prospects, Perils and the Public Interest

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Executive Summary

During the legislative debate over postal reform that stretched from 1995 to 2002, the creation of a price cap form of incentive regulation to replace cost of service pricing regulation became the central feature of the ongoing debate. A substantial record was established to explore the efficacy of price caps in the telecommunications industry, other US network industries and international posts in order to consider its application to the USPS. This paper reviews key features of that discussion to highlight a number of issues that are central to postal pricing reform.

The final position of the legislative reform debate that was suspended in 2002 was to defer to a proposed new Postal Regulatory Commission the task of devising a “modern” rate regulation process within 24 months of passage of the reform law. Two unresolved issues remain at the core of the discussion, whatever mechanics are selected for the final regulatory system:

- Can an incentive based regulatory process be effective in governing the actions of a public not-for-profit federal agency? And
- Can any price cap be effective if the reform legislation also contains the assurance contained in the postal reform proposal that nothing in the bill could interfere with the collective bargaining process?

This paper concludes that incentive pricing *can* be made to work for a public sector enterprise, albeit with the imperfections of adapting a system intended for a for-profit context, but *not* if prices are regulated without respect to costs. Labor costs must be taken into account in setting postal prices; and the reverse should be true as well. Pricing in a competitive market should be considered during labor negotiations.

Further, while the details of the regulatory process may be deferred at this stage, there is value in creating a policy framework to guide future regulators as they make complex choices in designing a “modern” system. A policy that cost and pricing decisions must be mutually adjusted is critical to making cost management possible. Without a sense of such goals and limits, the incentive regulatory cure might well be worse than the price escalation disease.

PRICE CAPS AND THE NEED TO IDENTIFY FIRST PRINCIPLES

Introduction, Incentive Regulation

This paper provides the President's Commission on the USPS with a brief background summary of past and current use of price caps in the telecommunications industry and other regulated industries and considers their effectiveness in providing rate predictability and improving productivity. The value of summarizing the work of policymakers, economists and regulators who have contributed to the discussion of this subject is to provide the President's Commission with background on the issues to consider in evaluating the desirability of a new incentive based pricing reform for the USPS.

In the past two decades, regulation in the telecommunications industry has been transformed from a tradition based upon cost of service regulation to a form of incentive based regulation that employs price caps. To a lesser extent, other network industries such as the electricity and gas industries have also moved toward incentive based regulation¹. In concept, the incentive based regulatory process would shift the focus from analysis of input costs to achieving results. This is the approach adopted by the Federal Communications Commission and most states with respect to telecommunications. Between 1989 and the mid-nineties both the FCC and the state Public Service Commissions in 38 states² transformed their approaches to regulating the telecommunications industry to employ some form of price caps. By many measures this change in regulatory philosophy has been successful in encouraging price reductions that have benefited consumers, although the extensive changes that have reshaped the telecommunications industry have subjected virtually all such evaluations to debate.

In the mailing industry, debate over legislative reform of the USPS focused on the proposed reform of the regulation of postal prices. The primary legislative vehicle, HR 22, that was the focus of debate from 1995-2002, proposed a form of price caps that would have redirected the work of a new Postal Regulatory Commission to replace the

existing Postal Rate Commission. Throughout this period, Congressman John McHugh (R, NY), Chairman of the Subcommittee on the Postal Service of the Committee on Government Reform and Oversight, guided the sustained debate over the efficacy of the price cap scheme and the regulatory apparatus that would be required to implement it. His Subcommittee's reform proposal advocating price cap pricing regulation for the USPS became the central vision around which the reform discussion turned.

Among the principal arguments that have been advanced to favor price caps has been their greater flexibility when compared with the current rate making process. In essence, postal management would be given the freedom, within constraints, to make adjustments in prices as long as they remained below the cap (an index calculated from the average of a selected basket of postal prices). The price cap mechanism would provide an incentive to management to introduce productivity improvement. Savings would create a means for funding a bonus pool to provide cash incentives for rewarding postal managers for their performance.

In addition to offering incentives, the forward-looking nature of price cap regulation would permit postal management to achieve a new openness and clarity in setting quantitative efficiency targets³. Assessments of whether a price cap form of incentive regulation would have an impact on postal management should note that it is extremely difficult today for postal management to set public quantitative cost reduction targets. Publication of such targets would always be difficult in the public sector. Targets are even more difficult to publicize during a postal rate case. Finally, the price caps would introduce a new commitment to rate stability and to greater financial transparency in permitting postal managers to publish simpler reports of costs and price projections. The difficulties of forecasting postal volume would be alleviated to some extent if the regulatory process did not depend upon these projections to set rates.

The new system would immediately yield greater clarity in one important sense. Today, the rate case mechanism often inflicts the burden on postal management to explain two sets of parallel numbers, one related to projections contained in a rate case

that might have been filed in the previous year and one that explains the current postal budget under current assumptions. These two sets of number not only often differ in an absolute sense, they are also cast for different audiences – regulators and Board members. At least in theory, the price cap mechanism would offer flexibility, incentives, stability and clarity.

At the same time, the extended debate provides a record that contains a detailed discussion of issues that concern the application of price caps to governing the USPS's pricing⁴. The main thrust of these issues concerning the application of the price caps form of incentive regulation to the current USPS involves at least five broad themes:

- *Application of incentives to a public not-for-profit enterprise.* The concern expressed by a number of economists was that there would be strong incentives to reduce costs and invest in efficiency producing measures primarily if the USPS were a *for profit* corporation. Opportunities to increase profits and create financial benefits for management and for shareholders, it was reasoned, are incentives for private entities and not government agencies. Substantial sanctions might be applied to a private company in the form of financial penalties. The argument that postal management has been quite successful in managing down the costs of the current enterprise and could be even more effective with more regulatory freedom were not persuasive to those who feel that it is essential that there be residual claimants in the form of shareholders to provide institutional leverage for the regulator.
- *Setting the initial cap(s).* Under the initial HR 22 concept, the price caps would be set following an extensive rate case (similar to the current process for setting rates) at the Postal Regulatory Commission⁵. The case would examine postal costs and would be used to establish a baseline of costs and prices. Some argued that the regulatory process that would be required to work *out* of the current cumbersome regulatory process could be more difficult to manage than the current rate cases. What is more, the law shifted the principal authority for making decisions from the Governors of the USPS where it currently resides to the new Postal Regulatory Commission.
- *The escalation of rates and the productivity offset.* In a deflationary market in particular, there is concern that the escalation of the price caps will not keep pace with other rising costs. Labor contracts have escalators that are not tied to economic indices. They were established in the bargaining process. The price cap, on the other hand, would be limited by the relatively flat economic forecasts. Further, witnesses who shared the USPS view argued that the unique characteristics of the USPS required that there be a customized Postal

Price Index created that better reflected productivity in the labor intensive USPS rather than general benchmarks drawn from the non-farm sector of the economy.

- *The review process.* If there are sufficient reporting and review requirements and if customers and intervenors are given rights to participate in the review process, some have argued that there is little difference between the new heavily reviewed price cap incentive regulation and the cost of service rate case style regulation that exists today. Considerable discretion would have been given to the new regulator under the proposed reform legislation.
- *The relation of the price cap to labor costs.* Finally, labor witnesses argued that the price cap would effectively serve as a wage cap and that as such it would interfere with the decision-making that takes place within the collective bargaining process. A special provision in the later versions of the reform legislation stated that nothing in the reform law could interfere with the collective bargaining process. This provision would make it possible for wage costs to increase faster than the escalation in prices and could have been interpreted by a neutral arbitrator or the new regulator as requiring that those responsible for setting costs could not pay attention to those responsible for judging compliance with caps on rates.

In considering the application of incentive based regulation in the form of a price cap, much of the legislative reform debate involved the effort to create the perfect cap. Economists who worked to understand the implications of the cap that was proposed in various forms in the different drafts of HR 22 noted that the way in which the price cap is structured is only part of the issue. A second part is the nature of the enterprise that is to be regulated and the character of the regulatory process⁶. Even a perfect price cap might have an impact that was diluted by the way in which incentives would be perceived. The impact of the incentives on management action and the extent to which postal management had tools that permitted them to manage prices are crucial issues that received only limited attention.

The Final Resting Point: HR 4970

In fact, by 2002, the debate was moving away from trying to craft the price cap in the legislation itself. Compromise legislation, HR 4970 did not try to specify the exact nature of the price cap, but, after 7 years of discussion, the task was given to the

regulator. The proposed legislation would have given the problem to the Postal Regulatory Commission with the charge to create a “modern system” for regulating rates within 24 months. The new system would be promulgated by regulation. The reform legislation would have framed objectives for the regulators: reducing costs and increasing efficiency, creating rate predictability and stability, maintaining high quality service standards, allowing pricing flexibility, assuring adequate revenues and reducing the administrative burden of the rate making process.

The Commission (to be called the Postal Regulatory Commission) would be given factors to take into account in creating this new rate setting process: creating a fair and equitable schedule, matching the value of the service provided, assigning attributable costs, minimizing the effect of rate increases, taking competition into account, the degree of preparation (worksharing), the simplicity of the structure, the value of different kinds of mail matter (need for classes), the need to create classes with high reliability and speed, the need for special classes for the user and the USPS and the educational, cultural, scientific and informational value of the mail to recipients. Then, having set forth the objectives for the reformed regulatory scheme that would govern prices and the factors that the Regulatory Commission would take into account, the compromise law directed the Commission to consider one or more of the following:

- Price caps, revenue targets or other form[s] of incentive regulation;
- Cost-of-service regulation; or
- Other forms of regulation that the Commission deemed appropriate.

After 7 years of debate over price regulation, Congress was deciding not to choose. A new regulator was given the direction to consider the form it deemed appropriate. But, the law went on to specify, in no case was postal management to permit any rate to increase faster than the Consumer Price Index without hearing and notice. Even then, the Commission would be required to determine that this faster-than-inflation increase was “reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue

the development of postal services of the kind and quality adapted to the needs of the United States.⁷” The proposed law, reflecting the strong views of the customers, set a very high hurdle for permitting escalation in postal rate increases.

The debate over incentive based regulation concluded, or at least paused to rest, in 2002 with the recognition that the stakeholders, competitors, employees and postal management could not reach agreement about the appropriate formula for regulating a publicly owned, not-for-profit enterprise. The customers were plainly concerned that there is a need for a price cap or some other form of constraint on the USPS management to moderate the trajectory of price increases such as those that were experienced in '99-'01. The regulators also shared a concern that since the USPS was a public entity without shareholders (i.e. residual claimants to the profits of the enterprise) they would have no leverage to enforce the price cap. The final draft of the law reflected these concerns on the part of Congress, the regulators and the customers. The effect was to create a powerful Postal Regulatory Commission with two years to create a regulatory regime instead of legislative reform gridlock.

Recent CSRS Legislation: The New Framework

The USPS is now required by the recent CSRS (retirement) legislation to respond to the Presidential Commission on the USPS's Report by the 30th of September⁸. The new law revised the formula for USPS contributions to the CSRS Fund and appeared to free up \$71 billion in future USPS financial resources by making it unnecessary for the USPS to make payments to the CSRS fund in the future. However, before the USPS can get the money, the new law requires that the USPS clarify its intentions with respect to future pricing of postal products⁹. The law also requires a response to the President's Commission's report. Sixty days later, (November 30, 2003) the General Accounting Office is required to make a report to Congress reviewing the USPS's comments. Within 180 days from the time that the Congress receives these reports, the Congress *may* wish to go back and “revisit” the law that was passed this spring. Indeed, Congress must act to release funds from an escrow account¹⁰. The Congress may act on a schedule of its

choosing to address in whole or in part, the issue of postal pricing. Also, as demonstrated with the CSRS legislation, the scope of the debate has widened. The President, the Executive Branch and the Treasury now are active players who will have a voice in future Postal policy debates. The Executive Branch did not take an active role in the debate through 2002.

By virtue of its scale, potential revenues at stake, potential value to the USPS and the way in which it is tied into USPS decision making for the foreseeable future, the CSRS law will become the new focal point for clarifying policy directions. The USPS will not only have to respond to the President's Commission's recommendations in writing, it will have to clarify its plans for debt structure, off balance sheet finance, capital investment and pricing. The significance of these new formal reporting requirements should not be underestimated. To make decisions about debt, financing, investment and pricing, the USPS will have to project future mail volumes and draw conclusions about competition and the potential efficiencies of a planned integrated postal network of the future. With so much at stake, there will be a new major decision point for Congress, The President and the USPS.

Defining First Principles

Will this new law and its promise of \$71 billion set aside the discussion of fundamental postal reform? Or, will the CSRS law's September 30 Report force projections of potential volume declines and make clear that postal prices could increase faster than inflation under a business as usual scenario? Between these two extremes – no reform and accelerating concern – lies a vast gray area. There is value in addressing first principles to set a navigation point to guide policymaking as the question is raised: did CSRS solve the USPS's financial problems or should the Congress return to the legislative reform debate? Of the five broad themes raised in the debate over pricing regulations, two of the issues, the efficacy of incentives to a not-for-profit enterprise and the relationship between the price cap and labor costs are fundamental issues involving the incentive to reduce costs and management's ability to act on those incentives.

Three other issues, setting the initial caps, escalation of the caps and the review process are critical issues that warranted extensive comments during the debate over HR 22. The discussion of these latter issues is included in this paper because it helps to illustrate the pros and cons of incentive pricing as it might be applied to the USPS. Today, many of the participants in the debate believe that price caps might have been an acceptable theory but the details of how they would have been implemented made them infeasible. This view primarily involves the mechanics of the process. The more fundamental questions involve the nature of the postal service to which incentive regulation would be applied and the tools that its management would have to control costs.

Price caps and incentive regulation have been shown to be effective in the telecommunications industry. If the future USPS is to remain a public agency and not have residual claimants in the form of shareholders, careful attention needs to be given to the structure of the institutions that will enforce the rate caps. A voluntary system, or one that inflicts management choices on the USPS (e.g. costs that cannot be controlled below a tight cap) that are impossible to reconcile with rising labor costs, is not likely to be effective.

Noting this, there are many ways to create incentives for public sector managers. There are substantial authorities – ranging from legislative directives to intervention, replacement of senior executives and loss of management control – that would provide significant leverage over postal management. Enforcement of an incentive scheme appears to be a more workable proposition than generally thought to be the case. Management of an enterprise like the USPS is in fact subject to a wide range of incentives and influence beyond profits and cash bonuses¹¹.

But influence is of limited value if management lacks the tools to act. HR 4970 contained an explicit directive (Section 405) that nothing in the law (including the yet to be designed “modern” regulatory system) could interfere with the collective bargaining

process¹². This provision means that while a cap might restrict postal prices, no price cap could be used to constrain wage increases (often referred to as 75-80% of the costs of the \$68 billion USPS). The presence of this section of the act could have created a situation that would have had an analogy to the California Electricity regulation of the late '90's where consumer prices were capped while the utilities were forced to buy power in markets that were not regulated. Similarly, making the escalation clauses that are contained in labor contracts (today or in the future) untouchable suggests the possibility in a deflationary economy that prices could be constrained while costs continued to climb, an obvious challenge to the viability of the price cap.

In general, to control labor costs the USPS can either reduce the number of labor hours that it purchases or reduce the price that it pays for the hours. Reductions in labor hours can be aided through investments in efficiency (e.g. introducing automation). But in the end, substitution of capital for labor still requires either capturing the savings from attrition (i.e. not hiring workers back) or a reduction in force if mail volume is not growing¹³. The price that is paid for labor on a cost per hour basis is subject to the collective bargaining process. An effective pricing policy must address the need to constrain each of the factors that drive labor costs as well as prices.

These are the first principles that must be addressed in recommending an approach to postal pricing of the core products¹⁴: the structure of incentives and the issue of management's capacity to control costs associated with labor. The appropriate level of regulatory supervision is an important question. One of the purposes in the development of incentive regulation was to reduce the burden of oversight that creates costs that are ultimately borne by consumers. While the details of the regulatory process may be left to the future, there is value in clarifying the extent to which there is an expectation of light handed regulation versus an expectation of more pro-active intervention. But while regulatory philosophy is important, the price management and cost reductions goals are what is present in the daily reality of USPS management. Today there is pressure on top management. Senior managers have difficulty in sharing this burden with middle level managers in the absence of management tools that make that communications process

clear. Senior management must be able to pass along the goals of reform with clear, quantitative performance expectations and incentives for success.

THE PRICE CAPS DEBATE

Background

The debate over legislation to reform the USPS began in 1995 when then Postmaster General Marvin Runyon spoke at the National Press Club calling for a new law to give postal management control over “people, prices and products”. A new Congress had just been elected and the changeover in the House of Representatives from a long series of Democratic led Congresses to Republican leadership stirred new policy debate in many areas. The reform of the USPS became one of these debates as Runyon’s speech followed several years of transition within the USPS and anticipated a time of increasing competition. In 1995 Congressman John McHugh became chairman of the Subcommittee on the Postal Service of the Committee on Government Reform and Oversight. From the spring of 1995 through June of 2002, this Committee worked to explore options for postal reform.

A central interest, if not *the* central interest of this discussion of postal reform was the review of pricing reform. The concept of moving from cost of service regulation to incentive regulation was controversial. On April 16, 1997, John McHugh’s Subcommittee explored the issues that were raised by the price cap proposal contained in the draft reform legislation, HR 22. This paper summarizes the salient points brought out in that hearing and in several papers that have been written since that time. In addition, the extensive and growing record of the President’s Commission was reviewed and interviews were conducted with key individuals who have participated in that debate – economists, regulators and former regulators, association executives, lawyers and postal managers.

The organic statute that created the USPS established a complex mechanism through which postal prices would be set. The Board of Governors of the USPS evaluates the financial condition of the USPS on an ongoing basis. A part of the Board's assessment is the adequacy of revenues to meet projected postal costs. The Board takes into account plans for investment in productivity and efficiency in making this assessment. When the Board anticipates that rising costs of the universal Postal infrastructure will exceed the revenues that will be generated from projected mail volumes at prevailing postal rates, the Board finds that there is a revenue requirement that must be met through an increase in postal prices, the Board makes a proposal to the independent Postal Rate Commission. The Commission normally takes 10 months to review the proposal and recommends a decision to the USPS Board of Governors for final action.

A proposal of new rates is a complex matter. Thousands of pages of economic justification are required by the quasi-judicial process that has been established through the interaction between the USPS, its regulator and the many parties to a rate case. Historically, as many as 85 parties have had a representative in past proceedings. To justify the new rate proposal, the USPS puts on witnesses who present testimony in support of the USPS proposal. These witnesses may be questioned by dozens of parties.

One of the factors that make this litigious practice of presenting rate cases as contentious as they often are is that many stakeholders see the process as a "zero sum game". If, for example, the prices of Priority Mail are raised, competitors who include the private delivery companies may benefit. Or, if rates for First Class Mail are increased and additional revenue can be generated, the pressure to raise Standard Mail rates could be lessened. Similarly, this pattern can be seen to involve sub-classes of mail. Within a single type of mail service such as Standard Mail, or Advertising mail as it is also known, catalogues, direct marketers or saturation mailers may each have varying interests with respect to different weights of mail.

The current pricing scheme that is managed by the Postal Rate Commission is based upon a “cost of service” concept. The analysis seeks to understand the USPS’s costs in providing various mail services. Cost and Revenue Analyses are presented to justify the costs and the need for additional revenue. Since increasing prices may decrease the attractiveness of the service to customers and may have an impact on volume (and thus on the revenue yield of a particular price increase) a great deal of attention is given to the way in which demand is likely to react to price increases. Elaborate demand studies are presented to support future volume projections, although the dynamic nature of cost, rate and volume analyses is a perennial subject of debate.

Understanding the current system is important in evaluating reform proposals. Into this carefully guarded, contentious process, entered the House Subcommittee in 1995. New pricing proposals became the central focus of debate when the Subcommittee explicitly excluded discussion of labor and the collective bargaining process (the central determinant of the cost side) from their deliberations. When a draft of the reform legislation introduced a price cap mechanism in the place of the traditional cost plus pricing, the stage was set for main reform debate.

The Case for Price Caps in the Postal Context and Elsewhere

The price cap mechanism that was proposed during the late 1990s sought to eliminate much of the discussion that takes place at the Postal Rate Commission today. The case for the price cap mechanism rests on several important characteristics.

- *Simplicity.* Instead of seeking to prove or disprove that the USPS has a revenue requirement, that the escalating costs that are presented to support specific price increase proposals are valid or that they will have the intended effect in providing financial support, a price cap mechanism would instead provide a formula that required the regulator only to determine whether or not the actions taken by the USPS were consistent with the rules of the cap.
- *Certainty.* The price caps would offer customers increased certainty in planning for the future and assurance that prices would not increase faster than inflation.

For the USPS, the certainty that is provided by having a price cap mechanism was thought to offer a number of specific advantages. The clarity of the escalation of prices would give the USPS a ceiling under which management would know that they needed to maintain costs in order to generate positive financial results. Customers would be given reassurance that future postal rates would be predictable.

- *Transparency.* Price caps would offer postal management the capacity to manage performance against a single set of numbers that must be published. Such a system would be radically different from the present. One of the challenges that face postal management today is the complexity of the bookkeeping. At the same time that the USPS must interact with the PRC as if market conditions did not change, the USPS must go ahead in managing its ongoing business. Thus, it is often the case that there can be two parallel conversations taking place – one with the commission about what the rates should be if the assumptions made 18 months earlier were true and another with the customers about actual market conditions. This problem of the parallel universe introduces tremendous uncertainty into both internal management decisions and in public communications. As a practical matter, the drumbeat of criticism in the postal industry as in others, causes the regulated entity be less open to the critics.
- *Alignment.* Price caps are thought to have the advantage of providing incentives that are correctly aligned with the interests of the customers. When Postal Management is given a price cap and permitted to generate new resources (in the private sector this would be called profits) by keeping costs beneath the cap, even excluding the productivity factor that recognizes the likely improvement over time, management is given greater incentive to do the hard things required to improve margins.

One observer of the regulatory process noted that one of the most important reasons that the cost plus system, or a cost of service-based regulatory system is problematic is that often the incentive for managers is to permit more costs to enhance the size of the base. Price caps, work in the opposite direction.

Incentive Regulation: Comparative Examples

Price caps are ultimately a form of incentive regulation that seeks to provide regulated firms with the types of profit-maximizing incentives that are typically found in a competitive market. They seek to create new freedom for the firm to take advantage of

opportunities to cut costs and create a bonus for performance. At their core, the incentive regulation seeks to promote the benefits for consumers of price regulation that are created by competition in spite of continuing regulation of monopoly powers. In its seminal Price Cap Order in 1989, the FCC stated that “[T]his Commission’s efforts were devoted to structuring regulatory policies that affirmatively promote competition, that rely on competitive forces as an effective means of assisting us in achieving our statutory goals, or that attempt to emulate the operations of a competitive market¹⁵.”

In a recent draft paper that is scheduled for publication, three economists with Christensen Associates reviewed the field of incentive regulation in the Telecommunications, Natural Gas and Electricity Industries¹⁶. The Hemphill, Meltzen and Schoech paper both reviews the conclusions of economists who have written in this field in the past decade and updates some important surveys of the extent of the application of price caps as a form of incentive regulation¹⁷. In the telecommunications industry, in addition to the FCC’s regulation of the long distance market, the vast majority of state regulators have now moved to a form of price cap regulation. Hemphill *et. al.* note that in 2002, rate-of-return regulation was used in six states, a rate case moratorium was present in one state, no states used earnings sharing mechanisms, and forty-one states had price cap regulation.

The Hemphill, Meltzen and Schoech paper concludes that the telecommunications industry has moved closer to pure forms of price cap regulation today than have the electricity and gas industries where this form of incentive regulation has also been employed. The goals of regulators have differed in these three industries as the character of the industries, particularly with respect to concentration, the opportunities for achieving productivity that are afforded by technology and concerns with service quality and impacts of deregulation have meant that there has been greater hesitancy to grant the freedoms that are associated with price caps to the electricity and gas industries has been seen in the telecommunications industry. Most fundamentally, the structure of the electricity and gas industries has meant that the Federal Energy Regulatory Commission (FERC) plays a different, less influential role in the structure and management of

individual utilities, as do the state public service commissions. The FERC's ability to regulate wholesale power sales is also mitigated by the concern with electricity network reliability. Telecommunications in the age of packet switching technology does not place this burden for sustaining the system on the regulator.

In the case of the telecommunications industry the structure of the industry grants regulators an opportunity to simulate competition and benchmark the simulation process in ways that have not been possible for managers and regulators in other industries. There is a clear difference between what was possible among the for-profit telephone companies that are regulated in 50 states as well as by the Federal Communications Commission and what has been possible even for the electric utility and gas industries. In addition to the regulatory structure and the character of the concerns for which regulators of the telecommunications industry have been responsible, telecommunications underwent a unique transition in the late 80s and early 90s as computers made dramatic cost reductions possible. Yet, in spite of these factors, regulators in other industries and in other nations' postal industries have been able to adapt the price cap mechanism to other purposes.

Indeed, the international comparisons of the application of price cap incentive regulations to foreign posts are interesting because of their scope. The debate over the potential application of price caps to the USPS led several economists to review international models in addition to domestic ones¹⁸ in 2000. David Treworgy, Thomas Sharkey, David Fronk and Michael Kehoe compared the postal systems in the major industrialized countries and found considerable evidence of the use of price cap regulation. Price caps were introduced in the early to mid-1990s in Australia, the Netherlands, New Zealand and Sweden. More recently, price caps have been used in Denmark and France. At the time of the paper, the German post was in the process of being privatized and the British regulatory regime was only beginning to take shape. In Germany pricing regulation has been introduced in stages over the past three years. In Great Britain the regulator Postcomm was established in the postal act of 2000 and in

2002 created a price cap formula under the RPI-X benchmark (Retail Price Index) that had become familiar in Great Britain under electricity price regulation.

The extensive experience with price cap regulation in the international posts offers evidence to economists on both sides of the debate. What has become clear is that a regulatory system cannot be effective on automatic pilot. Market conditions change. Customers, competitors and postal operators interact. Competition offers powerful incentives, as does the effect of simulated competition based upon incentive regulation. The role of the regulator is extremely important. In Germany, there is evidence that regulatory and policy consistency over time can support effective managers. Royal Mail (Great Britain), on the other hand, has had a more difficult experience.

Treworgy *et al* assert that there are three “aspects to the operating environment of a firm that can be considered critical components with respect to effective price-cap regulation: a well-crafted technical specification of the price-cap mechanism itself, solid ability of management to control and the existence of residual claimants to any profit earned. The authors found in 1999 that while the price cap model was being used throughout the postal world, it was not being applied to all of the products and services offered by the posts. In instances where there was limited coverage the remaining products were generally exposed to competition. With the exception of France, most of the posts were able to exercise cost controls as measured in terms of decreases in complements.

But in 1999 the posts that were only commercialized, as opposed to fully privatized, or that were still government agencies, received lower scores on the residual claimant measure. The authors reasoned that the posts that were insulated from the marketplace would be less likely to receive discipline from capital markets, their representatives or other shareholders. Their views were consistent with many of those who reviewed HR 22 and its potential application to regulation of the USPS, although their work was still largely descriptive. While there is broad experience with price caps

in the international postal world, experience with respect to monopoly products is still limited even today.

Five Issues for the USPS:

Application Of Incentives To A Public Not-For-Profit Enterprise

The concern expressed by a number of economists was that there would be strong incentives to reduce costs and invest in efficiency producing measures if the USPS were a *for profit* corporation. Opportunities to increase profits and create financial benefits for management and for shareholders, it was reasoned, are incentives for private entities and not government agencies. There would also be substantial sanctions that might be applied to a private company in the form of financial penalties. The argument that postal management has been quite successful in managing down the costs of the current enterprise were not persuasive to those who feel that it is essential that there be residual claimants in the form of shareholders to provide institutional leverage for the regulator.

Gregory Sidak, Resident Scholar, American Enterprise Institute, stated that the provisions of HR 22 that would have created bonuses for postal executives who were successful reducing costs would be ineffective. He stated “those provisions [will not] go far enough to replicating what private enterprise is able to do in terms of creating incentives for profit-maximizing, cost-minimizing behavior.” His view was that there was very little basis for believing that price caps would work in the non-profit context because all of the experience with price caps was in situations where there was a shareholder constituency¹⁹. The existence of shareholders with a financial stake in the results of cost reduction and productivity programs would establish market discipline on management.

Mr. Sidak believed that there were at least three fundamental flaws with the application of price caps to the USPS context, the widely noted concern that the incentives would not work well with an institution that was not a profit maximizing enterprise. The concern that the labor to capital ratios of the USPS would not permit the

kind of cost reducing improvements available to the management of telecommunications companies who were able to take advantage of dramatic technology improvements in productivity. And the availability of 50 state regulatory entities made it possible for telecom costs to be benchmarked in a manner that that would not be available to the mailing industry that was focused on the actions of one regulator. In the telecom industry the regulators could continuously improve the price cap mechanisms by watching the actions of other state regulators.

For some of the witnesses who testified before Congress, the remedy to the problem raised by Mr. Sidak and others – that the incentives would not work effectively for a not-for-profit institution – was to privatize the USPS. Professor Michael Crew of Rutgers University stated “For the good intentions of HR 22 to bear fruit...the Postal Service should cease to be a public enterprise²⁰.” He further stated, “It comes as no surprise that the U.K.’s adoption of price caps regulation for its newly privatized industries are generally cited as a major success story.” But he noted, in the UK “Price cap [regulation] in the U.K. was successful because the industries concerned were privatized. For price cap regulation to succeed, there must be residual requirements²¹” was the view of Professor Crew and many others.

Strong views that have been expressed over the years that have followed the proposal that the mailing industry pricing be regulated by price caps. Economists and regulators believe that the new incentives have limited effect without shareholders. Some of those who hold this view most strongly believe that even the current regulatory system is unable to constrain the USPS. The Postal Reorganization Act of 1970 limited the power of the regulator to recommending, rather than promulgating rates. The five members of the Postal Rate Commission are appointed by the President. Their decision may be overridden by the action of nine other Presidential appointees, the Board of Governors of the USPS. Some regulators believe today that the 1970 law created such a strong entity that it would be immune to incentive, shielded from competitive forces and could continue to override the action of regulators.

This view that the USPS is stronger than regulatory constraints was reinforced in the view of the regulators in 2001 by the Board of the USPS's action in overriding the recommendation of the Commission. Commissioner Ruth Goldway, for example, questioned the USPS's contention that it required new freedoms to adjust postal prices. Commissioner Goldway does not believe that the USPS can credibly argue that it requires pricing freedom in light of its ability to reinstate its proposed rate increase and to gain new flexibility today through Negotiated Service Agreement arrangements.

In hearings before the Senate Governmental Affairs Committee in the spring of 2001, then Chairman Fred Thompson appeared to share the view that the current postal pricing regulatory structure allowed considerable, if not too much freedom. He reviewed the powers of the Reorganization Act with Chairman of the Postal Rate Commission George Omas. Chairman Thompson expressed strong skepticism with the efficacy of a regulatory system that would permit the regulated party to make a proposed rate increase, go through months of formal hearings, receive the proposal of the Rate Commission and then override the decision to reinstate its initial proposal.

There is a contrary view that has been advocated by the USPS, that the current regulatory process is far more burdensome than often appreciated. Also, there is a case to be made that the one instance of the Board overriding the Rate Commission was unique. In the view of the Board at the time, the PRC was making a unique challenge to the Board's judgment that revenue was required. The revenue requirement concept is analogous to the concept of reliability to the electric power and gas industries. Postal management and the Board of Governors concern with meeting the revenue requirement is shaped by their view of their fiduciary responsibility. The Board understands that it is responsible for the continuity of an institution that has a responsibility to reach every American household everyday and the ever-present reality of ongoing mail volume that delivers 500,000 pieces of mail at postal facilities every night. This daily requirement to manage the pipeline of mail flow requires a workforce that today equals 750,000 workers that must be paid every other week, hence the concern with sustaining the system. The Postal Rate Commission's decision in 2001 that was overridden by the Board of

Governors, after the PRC challenged the USPS estimate of the revenue requirement and thereby struck at the heart of this concern with sustaining operations.

Assuming that in normal times, there was no challenge to the Board's revenue requirement estimate for sustaining operations, the question would be: would the USPS management be influenced the incentives of a regulatory process that was structured differently? Is the extensive current ratemaking process required? The ability of postal management to reduce costs following the publication of the Transformation Plan and the success that was achieved in pursuing the first Negotiated Service Agreement²² is seen by the opponents of reform as evidence that the current framework established under the Postal Reorganization Act already permits flexibility.

This discussion has focused on recent history, on the events that have shaped the views of regulators and management. Importantly, it should also be noted that a forward-looking perspective would focus on the eroding power of the monopoly in a competitive market. To the extent that the USPS is facing competition in key markets, the problem of not having residual claimants becomes somewhat self-correcting. Professor William J. Baumol of New York University and professor emeritus at Princeton University noted, "Hearings such as this are characterized by predictability of the contentions of the witnesses associated with the different interested parties²³." He noted that the witnesses for the competitors generally advocate principles that will prevent a reduction in prices while witnesses for the customers will take the opposite position. Yet "immunity from competition for the Postal Service grows increasingly elusive, even if it were considered desirable, the necessity of increased flexibility in decision making, with decreased delay in adaptation to rapidly evolving market conditions becomes ever more imperative²⁴."

Professor Baumol's perspective was shaped by his view of the growing "threat from electronic competition and rivalry from other sources²⁵." In his view "though the price-cap mechanism was designed for the circumstances of a privately-owned, profit-seeking firm that is regulated to prevent the exercise of market power, it is possible in

principle to adapt the arrangement to the situation of an enterprise such as the Postal Service²⁶.”

In the final analysis, there is no “good”/forward looking perspective and “uninformed”/backward looking one. The issue that differentiates the view that flexibility already exists and reform is not needed or is unworkable from the view that even imperfect regulatory reform is necessary is often an analysis of pending competition. During the debate one economist noted that the question is not whether mail volume will be subject to electronic and other forms of competition, the question is “when”? Those who believe most strongly that, for example, First Class Mail volume will soon come under pressure from electronic bill paying and presentment substitution tend to believe that even imperfect incentive regulation should be tried.

Setting The Initial Cap(s)

Under the initial HR 22 concept, the initial caps would be set following an extensive rate case at the Postal Rate Commission. This case would examine postal costs and would establish a baseline of for the pricing formula. Some argued that the regulatory process that would be required to work *out* of the current cumbersome regulatory process could be more difficult to manage than the current rate cases. What is more, the law shifted the principal authority for making decisions from the Governors of the USPS where it currently resides to the new Postal Regulatory Commission.

One of the concerns of the USPS also noted by economists who presented their views to Congress was the way in which inflation would be measured. Dr. Laurits R. Christensen of Christensen Associates submitted a written statement in which he stated that price cap regulation which had been successfully implemented in the telecommunications and railroad industries yet “the Price Cap plan must be carefully crafted to reflect the Postal Services unique characteristics²⁷.” Dr. Christensen noted that constructing the index in a manner that was similar to the telecommunications industry’s “GDPPI – X” formula would compare the USPS’s pricing to a benchmark that could

impose severe financial problems. In the capital-intensive telecommunications industry²⁸ prices would be permitted to increase on a rate equal to the general rate of inflation as measured by the Gross Domestic Product Price Index. The USPS and Dr. Christensen advocated a different approach, constructing a Postal Pricing Index that would more accurately reflect the actual costs and capital/labor profile of the USPS.

The National Regulatory Research Institute at Ohio State University was asked to comment on the USPS proposal for the record. Their response recognized the problems that were associated with the GDPPI as a measure of economy wide inflation and the fact that it was “a poor proxy for price changes at the Postal Service²⁹.” Yet the economists from the National Regulatory Research Institute held the view that creating a blended index to apply solely to the postal service seemed “ad hoc”. They recommended that despite its deficiencies that GDPPI be used but that adjustments be made in the X Factor. Further they explained that the X factor could represent multiple factors such as costs, revenue, productivity, service quality and demand.

This exchange offers a good summary of a significant part of the discussion of postal reform. The design of the formula for establishing the Price Cap raised a number of technical questions such as How should inflation be measured? How should predicted productivity improvements be taken into account? How could the regulatory process establish goals that would encourage the USPS to stretch? From the point of view of the USPS, it was important to select the right measure and to “hard wire” the formula in a manner that would minimize the discretion of the regulator. Hardwiring the parts of an imprecise formula left the debate turning on the many deficiencies that were found in individual plans.

The Escalation Of Rates And The Productivity Offset

In a deflationary environment in particular, there is concern that the escalation of the price caps will not keep pace with other rising costs. Labor contracts have escalators that are not tied to economic indices. They were established in the bargaining process.

The price cap, on the other hand, would be limited by the relatively flat economic forecasts. Further, USPS witnesses argued that the unique characteristics of the USPS required that there be a Postal Price Index created that better reflected productivity in the labor intensive USPS rather than the benchmarks of the non-farm sector of the economy in general.

Professor Paul Keindorfer of the Wharton School testified in the McHugh Hearings in 1997 that he was concerned with the structure of baskets and with the uniform applicability of adjustment factors within baskets. He noted that in HR 22 “no individual price within any basket is allowed to increase by more than the price index which is specified in HR 22 as the GDP price increase less X. This contrasts with the more common arrangement where the prices in the basket are aggregated into an index which is allowed to increase – the index that is – by GDP minus X^{30} .”

As Professor Kleindorfer and others note, the way in which the cap is calculated and the way in which the productivity offset is applied in the regulatory process can take away as much freedom as is granted by making the change in the first place.

The Review Process

If there are sufficient reporting and review requirements and if customers and all parties to a case are given rights to participate in the review process, some have argued that there is little difference between the heavily reviewed price cap incentive regulation and the current cost of service rate case style regulation that exists today. Considerable discretion would have been given to the regulator under the proposed reform legislation.

The review process was of considerable concern to the USPS. Since the existing regulatory process caused the USPS to engage in litigation-style proceedings, there was concern that the regulator, if given too much discretion would create hurdles for postal management that could not be cleared. To begin with, there were questions of definition and intent. For example, Treworgy et al (1999) note that the British telecommunications

regulator did not view the X factor as a productivity offset when creating the price cap for BT, yet the FCC did consider the X factor such an adjustment.

The regulatory economists from the National Regulatory Research Institute noted that the X factor could be “hard wired” as recommended by Dr. Christensen and the USPS. But they also noted the British system in which the regulator is given discretion to take a number of factors into account in determining the productivity offset is a more flexible model. This is of course exactly what was of concern to the USPS. Watching the difficulties of Consignia or Royal Mail as the British postal system was variously called with the British regulator, Postcomm, USPS management sought to structure a regulatory process that would be both predictable in the short term and also would allow for extreme contingencies. Postal management would have had difficulty in presenting any other system to the Board of Governors that was generally opposed to the various forms of reform during the period 1999-2002. But objections to the review process led to so little consensus that the final version of the reform bill defaulted the design of the incentive regulatory system to the new regulator to design over a 2-year period.

The Relation Of The Price Cap To Labor Costs.

Finally, labor witnesses argued that the price cap would effectively serve as a wage cap and that as such it would interfere with the decision-making that takes place within the collective bargaining process. A special provision in the later versions of the reform legislation stated that nothing in the reform law could interfere with the collective bargaining process (HR 4970, Section 405) thereby making it possible for wage costs to move faster than the escalation in prices.

Labor witnesses were unambiguous about their views of the proposed reform.

“The most onerous, yet unnecessary, provision of HR22 is its price cap provision. The bill is one that calls for the use of the Gross Domestic Product Price Index (GDPPI) to set the limit by which the bulk of postal rates can rise...A price cap in a labor intensive

industry is effectively a wage cap,” stated Joel Popkin based upon research conducted on behalf of the American Postal Workers Union. Dr. Popkin went on to clarify his view that the price cap was “a device to deny postal workers increases in living standards”. In the view of Dr. Popkin the productivity offset or “stretch factor” was a “wage constraint”. His testimony was quite clear. He notes that the objective of HR 22 was to “keep postal rate increases well under overall inflation” (it was). “Such an objective,” he noted, could “only realistically be met by forcing real wage losses on the working people of the postal system.”³¹

On the other hand, economic witnesses such as Professor Michael Crew of Rutgers University and Professor John Panzar of Northwestern University noted the significance of the arbitrator’s decision given the history of the USPS being subject to compulsory arbitration. With this threat in the background they noted, a significant question would be posed for the regulator charged with managing the price cap. Would the regulator ignore the potential impact of labor settlements or would the regulator take them into account and thereby use the labor settlements in adjusting the X factor? Professor Panzar noted that this was an issue that would have to be addressed³². Ultimately, the proposal outlined in HR 22 was adjusted, first, to direct the regulator that nothing contained in the bill could be construed interfere with the conclusions of the collective bargaining process and then in the final 2002 proposal to remove any direction at all and defer to the new Postal Regulatory Commission the task of defining a modern postal regulatory system.

In recent years, perhaps because of a new era of good feeling and trust in labor-management relations or because the unions have recognized the competitive threats noted by Professor Baumol in 1997, there have been labor settlements that did not go through to the compulsory arbitration process. In 2003, the compulsory arbitration requirement may seem less of a burden to postal policy makers.

But there has been no change in the collective bargaining rules governing the USPS. And, labor leaders and their representatives have testified before the President’s

Commission that there is no need to change the current business model of the USPS with respect to the collective bargaining process. In spite of today's amity, in the background the requirement to go to arbitration if the parties cannot come to agreement remains. Without policy guidance that the arbitrator and the regulator must recognize the decisions that one another are making, there remains a force of potential cost increase that will undermine the incentives in even the perfect regulatory scheme.

In addressing this issue, the reform does not have to be as simplistic as the witnesses who attacked a "wage cap" suggested. A multi-stage process could be designed to phase in mutual cost and price adjustments. If the mutual adjustment process proves to undermine the pricing process or to interfere with the rights of workers, it could be modified.

For a pricing mechanism to grant USPS management the tools necessary to control costs (and thereby make the incentives encouraging cost reductions meaningful) the impact of labor settlements must be considered as a component of the regulatory incentives. Professor Panzar's view in 1997 that the issue of labor costs must be addressed remains valid today in spite of changes that may have been introduced by growing awareness of competition and threats to the future viability of the postal system.

Conclusions

This paper concludes that the price cap form of incentive regulation could be adapted to the USPS context. While USPS price caps would offer an imperfect representation of the incentives that would be provided to the managers of a for-profit enterprise in a competitive market, there would be substantial positive benefits that could come from reforming the current regulatory process. The comparative flexibility of price caps, the opportunity to create new transparency and, most importantly, the clarity of incentives that could be created would offer benefits that would outweigh their limitations.

There are a number of reasons for this view in addition to the support that it received from a number of economists in the 1997 debate. The likelihood that the USPS core products could soon face significant competition from electronic alternatives as well as other forms of competition argues for a new, more flexible regulation of postal prices. Further, the limitations of applying price cap incentives to a not-for-profit enterprise, while significant, are not as debilitating as suggested in the debate. There is a valid argument that without shareholders, postal management is not subject to the influence that competition would place on a for-profit firm. Yet, these are not the only form of incentive signal to management.

A perspective given little attention in the debate was the nature of incentives that already influence senior postal management. The managers of this \$68 billion public enterprise may not be compensated on a private sector standard, but there is abundant evidence that they are highly responsive to clear directions from the marketplace, from regulators and from policy makers. The issue is more often that they are given too many signals than that they are not responsive to the ones they receive.

One contribution to clarity would be given by aligning the incentives of postal management to reduce costs below a price cap with the interests of customers to have predictable costs of their own in the form of postal prices. A second important contribution to clarity would be a regulatory process that made it possible for senior postal management to pass along the pressure for performance in clear, quantitative terms.

At the same time, there must be alignment with the long-term interests of the workforce as well. The benefits of the new regulatory process would be undermined if both regulators and arbitrators of labor contracts, as well as postal management and the leaders of labor unions and management associations were given the guidance that cost decisions and pricing decisions were intended to be made independently from one another. Aligning costs and pricing could well prove so controversial that several years would be required to phase the new process in. Nonetheless, over several years a new

mechanism should be established that requires interconnected adjustment of both cost and price to meet the requirements of a new, more competitive market.

¹ Hemphill, Ross C., Meltzen, Mark E. and Schoech, Phillip E. of Christensen Associates, “Incentive Regulation in Network Industries: Experience and Prospects in the Telecommunications, Natural Gas and Electricity Industries”, 2003, a paper scheduled for publication made available through the courtesy of Christensen Associates.

² State Telephone Regulation Report, March 20, 1997. Provided to the McHugh Subcommittee on the Postal Service by Kenneth Rose, economist at the National Regulatory Research Institute.

³ A classic illustration of the problem that is created in the current cost of service style of regulation was demonstrated in 1999 when Postmaster General William J. Henderson announced the quantitative goals of “breakthrough productivity” during a rate case. Setting cost reduction goals at the same time that revenue requirements are being projected causes management difficulties. This is a phenomenon for which there are many examples.

⁴ Indeed, any listing of concerns will leave out important points that were raised by experienced economists and regulators. A single valuable source that was used extensively in this discussion was the hearing record of the Subcommittee on the Postal Service of the Committee on Government Reform and Oversight, April 16, 1997.

⁵ The new Postal Regulatory Commission would be granted new powers which, it should be acknowledged represented a substantial cause for concern among some who reviewed the reform proposal. The new Commission would have subpoena power and would have the final decision authority, two distinct differences from the current process.

⁶ In Europe today there are a variety of examples of posts that have been subjected to what might be considered to be a sympathetic regulatory process and others that have not been supportive. In the latter case there is always a question of whether things went badly because of the regulator or because of mismanagement. But the point remains that across Europe and across other US industries there are many examples of acceptable regulatory schemes that were managed in a way that did not ensure the long-term viability of the regulated party.

⁷ HR 4970 p. 9.

⁸ On April 22, the Congress passed a reform of the postal retirement system affecting Civil Service Retirement System employees. The bill adopted the language in S. 380.

⁹ See Benjamin, Maynard and Reisner, Robert, “The Cloud Over the Commission: The Story of the CSRS Legislation” prepared for the June 2002 Crew and Kleindorfer Conference on postal and network industries. The author presented the content of this paper in a meeting of the Postal Policy Institute, May 8, 2003.

¹⁰ Technically, the CSRS legislation permits the USPS to expend funds for the first three years. In the first two years, the new law directs the USPS to apply those funds to reducing its debt. In year 3 the USPS is to use the funds to avoid having to raise postal rates. The funds in escrow involve the funds that would have been paid to the Office of Personnel management for the Civil Service Retirement Fund after year 3 under the old formula. This is the escrow fund that will require Congressional action before the USPS can spend the money.

¹¹ From 1996 through 2001, an Economic Value Added (EVA) system was used to grant cash bonuses to postal managers. The system was not beyond criticism. Nor were its incentive signals perfectly aligned with USPS strategy. Even so, it is difficult to argue that the EVA system was not a powerful tool in guiding the complex USPS during a time of dramatically improving performance. See Reisner, Robert, “When a Turnaround Stalls”, *Harvard Business Review*, February, 2002. The EVA system was dismantled in 2002 amid criticism of awarding bonuses to managers in an institution that was not net income positive.

¹² Section 405 of the proposed HR 4970 reads “Noninterference with Collective Bargaining Agreements, etc. (a) Nothing in this Act or any amendment made by this Act shall restrict, expand, or otherwise affect any of the rights, privileges, or benefits of either employees of or labor organizations representing employees of the United States Postal Service under chapter 12 of title 39, United States Code, the National Labor Relations Act, any handbook or manual affecting employee labor relations within the United States Postal Service or any collective bargaining agreement”.

¹³ This paper discusses the postal system as if it were a homogenous national entity. In some ways it is. But the discussion of the capacity of the system to control labor costs by reducing labor hours alone (and not limiting wage increases) highlights the other factors that also influence USPS costs. In some parts of the country, mail volume is not declining but is in fact growing because of regional economic growth. In these cases, the inability to shift the workforce geographically or among craft unions is a major constraint to cost reduction.

¹⁴ The discussion in this paper focuses on the core products to remain focused on the efficacy of incentive regulation. There are additional issues raised in discussing the pricing of non-core, competitive products and new or experimental products. In essence, the core products even under a price cap do not exist in a vacuum and issues of cross subsidy must be addressed when they are considered.

¹⁵ Federal Communications Commission (1989) (“AT&T Price Cap Order”), para. 25.

¹⁶ Hemphill, Ross C., Meltzen, Mark E. and Schoech, Phillip E. of Christensen Associates, “Incentive Regulation in Network Industries: Experience and Prospects in the Telecommunications, Natural Gas and Electricity Industries”, 2003.

¹⁷ Chunrong Ai and David E.M. Sappington (2002), “The Impact of State Incentive Regulation on the U.S. Telecommunications Industry,” *Journal of Regulatory Economics*, Vol. 22:2, 2002 updated by Hemphill, Meltzen and Schoech.

¹⁸ A good summary of the International Models was presented in one of the papers presented at the Crew and Kleindorfer conference on postal and delivery economics in 1999. David E. Treworgy, Thomas M. Sharkey, David R. Fronk, Michael J. Kehoe, “Price-Cap Regulation in the Postal Sector: An International Comparison and Assessment”.

¹⁹ Testimony of Gregory Sidak, Resident Scholar, American Enterprise Institute before the House Subcommittee on the Postal Service of the Committee on Government Reform and Oversight, April 16, 1997, p. 87.

²⁰ McHugh Hearings, April 16, 1997, Professor Crew page 101. In later years Professor Crew would be joined in his view that the USPS should be privatized by public officials such as Postal Rate Commissioner Ruth Goldway and former Postmaster General William J. Henderson as they both stated in 2001 editorials in the Washington Post.

²¹ Professor Crew, April 16, 1997, page 101.

²² A Negotiated Service Agreement was granted to the USPS for an agreement with Cap One, May 16, 2003.

²³ “Comments on the Price Cap Proposal for the U.S. Post Office: Promises and Avoidable Perils for the Public Interest” William J. Baumol, McHugh Hearing Record, April 16, 1997, p. 266.

²⁴ Ibid, page 266.

²⁵ Ibid., page 267.

²⁶ Ibid., page 267. The title of this paper is purposely chosen as an echo of Professor William J. Baumol’s 1997 testimony.

²⁷ Dr. Laurits R. Christensen, McHugh Hearing Record, April 16, 1997, p 248.

²⁸ Dr. Christensen noted that in the telecommunications industry labor costs were generally thought to comprise 25% of total costs as compared with 80% of postal costs. While there is considerable discussion possible about the extent of USPS costs that would be comprised of labor costs if incentives were restructured, the extent of the different noted by Dr. Christensen makes clear that there would likely be a significant problem for the USPS if it were benchmarked against a different industry’s profile.

²⁹ Responses to Questions for the Record following the Hearings on April 16, 1997 regarding HR 22 by Kenneth Rose, Kenneth Costello, Raymond Lawton, Vivian Davis and Nancy Zearfoss, The National Regulatory Research Institute, Ohio State University p. 174 of McHugh Hearings, April 16, 2003.

³⁰ Professor Paul Kleindorfer, McHugh Hearings April 16, 1997, page 102.

³¹ Testimony of Dr. Joel Popkin, Joel Popkin and Company, testimony in McHugh Price Cap Hearings April 16, 1997, page 76 and 77.

³² Comments of John C. Panzar on HR 22, McHugh hearing record page 258.