BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

Priorities for Future Data Collection And Analytical Work Relating to Periodic Reporting	Docket No. RM2022-1

COMMENTS OF THE
<u>NATIONAL POSTAL POLICY COUNCIL</u>
(March 25, 2022)

The National Postal Policy Council ("NPPC") respectfully submits these reply comments in response to comments on Order No. 6004.[1] That Order invited interested parties to suggest topics for research that could improve quality, accuracy, or completeness of data provided by the Postal Service in its annual reports. The Commission expressed particular interest in research that could have an impact on estimated volumes, cost or revenues.

NPPC respectfully suggests that a desirable area of research would be the effects of nominal (not inflation-adjusted) price changes on postal demand. Currently, the Postal Service's demand models are specified using "real" – that is, inflation adjusted – prices. One consequence of that is that during the years since enactment of the Postal Accountability and Enhancement Act in which price changes by class were, with the exception of the duration of the exigent surcharge, capped at inflation (and the Postal Service invariably used virtually all

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1 Order No. 6004, Docket No. RM2022-1 (Oct. 8, 2021) (Notice and Order of Proposed Rulemaking on Periodic Reporting).

of the available pricing authority), there were almost no changes in real, inflation-adjusted prices.

With virtually no "real" rate change over that period, the Postal Service's demand models unsurprisingly have found little price elasticity for market-dominant products. However, as the Commission well knows, the volume of market-dominant products has declined steadily over the same period. Something has to account for that decline.

The Postal Service's demand models have had to use other variables, not expressed in prices, to account for volume changes. Some of those variables, such as employment and gross national product, have economic content. However, other variables in the current demand models have no inherent economic content; rather, they are time trends or non-linear intervention variables, or non-seasonal dummy variables.[2]

There is a disconnect between the use of "real" prices in these models and how businesses operate. Businesses do not set budgets or conduct business in real terms. Nor, for that matter, does the Postal Service. Neither private businesses nor the Postal Service report annual results using inflation-adjusted dollars. The Postal Service's financials do not deflate its revenue by inflation; instead, they present year-to-year comparisons in the nominal dollars, unadjusted for inflation, in which it was collected.

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[2] *United States Postal Service's Demand Equation Estimation and Volume Forecasting Methodologies* (January 20, 2022). The Postal Service has found it necessary to use these variables to make the models account for observed volumes.

With regard to mailers' responses to postal rates, private businesses such as NPPC members use actual (nominal) prices in their planning and budgeting.[3] If a business increases profits three percent in a year in which inflation was four percent, it announces a successful year. It does not say that its results declined by one percent. Similarly, if postal rates and inflation both rise by two percent, the business views that as a two percent increase in mailing costs despite the real economic increase being zero. And rate increases in the range of 6 to 8 percent, such as in August 2021 and likely (based on Postal Service statements) July 2022, make the disconnect between nominal and real prices even more dramatic. Businesses certainly notice the sticker shock.

And few businesses can simply or willingly increase their postal budgets in response. An assumption that an increase in postal prices results in an equal increase in a business's mailing budget would run contrary to the experience of many NPPC members. Instead, higher postage rates mean that mailers simply cannot and do not mail the same volumes of mail at the same rate categories as they did previously. This could easily result in less mail than might be forecast by demand models that rely on inflation-adjusted postal prices.

NPPC believes that if nominal prices were used in the modeling, some of the explanatory power could shift from those current variables that lack economic content to prices. That could result in higher price elasticities. If so, this would

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[3] The Postal Service does the same.

mean that prices that are higher nominally even if unchanged in “real” terms would reduce volumes and hence revenue more than currently predicted.[4]

At the very least, the Commission should consider testing these formulations because of their possible effect on how inflation through nominal price increases affect volume and revenue from market-dominant products.[5]

The Postal Service files its current demand models in January, outside of the annual compliance review process in 39 U.S.C. §3652. However, the Postal Service presumably takes demand into account when developing its integrated financial plan and related financial projections. And the Commission uses the demand models when considering exigency requests under 39 U.S.C. §3622(d)(1)(E) and when considering negotiated services agreements for market-dominant products. The Commission itself relied on the same estimates of price elasticity when authorizing the Postal Service to raise rates by more than inflation.[6] Thus, the Commission has a responsibility to oversee whether such plans are based on the most accurate information, including price elasticities and demand modeling.

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[4] The Commission has recognized that the Postal Service’s models “are not specifically designed to estimate the price elasticities of individual products.” Order No. 536, Docket No. RM2009-3, at 57 (Sept. 10, 2010).

[5] A related issue to study is how long such effects might take to appear in the demand models, because the Postal Service’s current models treat demand as a function of lagged prices.

[6] Order No. 5763 at 186-187 & n.260 (Nov. 30, 2020), aff’d *National Postal Policy Council et al. v. Postal Regulatory Commission*, 17 F. 4th 1184 (D.C. Cir. 2021), *petition for writ of certiorari pending* (filed Feb. 10, 2021).

Accordingly, the National Postal Policy Council respectfully urges the Commission to consider studying the effect of nominal, rather than real, price changes on the demand for market-dominant postal products.

Respectfully submitted,

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