Postal Rate Commission
Submitted 9/22/2006 4:23 pm
Filing ID: 53559
Accepted 9/22/2006

UNITED STATES OF AMERICA
Before The
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

Rate and Service Changes To Implement Baseline Negotiated Service Agreement With Washington Mutual Bank	)))	Docket No. MC2006-3

RESPONSE OF OFFICE OF THE CONSUMER ADVOCATE
WITNESS JAMES F. CALLOW TO INTERROGATORY OF
WASHINGTON MUTUAL BANK (WMB/OCA-T1-5)
(September 22, 2006)

The Office of the Consumer Advocate hereby submits the response of James F. Callow to interrogatory WMB/OCA-T1-5, dated September 8, 2006. The interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

SHELLEY S. DREIFUSS
Director
Office of Consumer Advocate

EMMETT RAND COSTICH
Attorney

901 New York Avenue, NW Suite 200
Washington, D.C. 20268-0001
(202) 789-6830; Fax (202) 789-6891
e-mail: costicher@prc.gov

RESPONSE OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORY WMB/OCA-T1-5

WMB/OCA-T1-5.

Please refer to your response to WMB/OCA-T1-2(d) where you explain how cost savings "could be incorporated into the Panzar analysis." Please also refer to your response to WMB/OCA-T1-1(f) where you provide a Panzar analysis using a price-difference elasticity of -.8538. Finally, please refer to Table 4 on page 9 of WMB-T-1, which shows after-rates First-Class Mail volume forecasts of 713 million, 750 million, and 785 million pieces, respectively, for Year 1, 2, and 3 of the NSA. For the purpose of this interrogatory, please assume that WMB's own-price elasticity for First-Class Mail is zero.

(a) Based upon a Panzar analysis that incorporates cost savings using the method described in your response to WMB/OCA-T1-2(d), what is the minimum price-difference elasticity that would result in a Year 1 USPS net benefit at an after-rates volume of 713 million First-Class Mail pieces? Please provide all of your underlying calculations.

(b) Based upon a Panzar analysis that incorporates cost savings using the method described in your response to WMB/OCA-T1-2(d), what is the minimum price-difference elasticity that would result in a Year 2 USPS net benefit at an after-rates volume of 750 million First-Class Mail pieces? Please provide all of your underlying calculations.

(c) Based upon a Panzar analysis that incorporates cost savings using the method described in your response to WMB/OCA-T1-2(d), what is the minimum price-difference elasticity that would result in a Year 3 USPS net benefit at an after-rates volume of 785 million First-Class Mail pieces? Please provide all of your underlying calculations.

RESPONSE TO WMB/OCA-T1-5

The "minimum" price-difference elasticities requested are unrelated to, and can only be derived separately from, the cost savings estimated by the Postal Service. The estimated cost savings from the provision of electronic address correction notices are calculated from Postal Service costs of providing electronic versus physical returns and a subset of Washington Mutual's after-rates volumes. As described in my response to WMB/OCA-T1-2(d), the Postal Service's estimated cost savings "would be added to the

'Net USPS Benefits'," which is estimated separately using a price-difference elasticity in the Panzar analysis.

As requested, however, the "minimum" price-difference elasticities can be derived from Washington Mutual's before-rates and after-rates point volume estimates for each year, the average revenue per piece for First-Class Mail marketing letters and Standard Mail letters, and the agreement's negotiated discounts. Assuming Washington Mutual's own-price elasticity for First-Class Mail marketing letters is 0, the form of the equation is

$$Q_0 = Q_1 \quad 1 \quad \frac{d_0}{d_d}^{E_d}$$

where E_d is the price-difference elasticity, Q_0 and Q_1 are Washington Mutual's before-rates (450, 475, and 500 million) and after-rates (713, 750, and 785 million) point volume estimates, respectively, for each year, d_0 is the before-rates average marginal price difference between First-Class Mail marketing letters and Standard Mail letters ($0.346 - $0.206), and d_1 is the after-rates marginal price difference at the highest negotiated discount ($0.346 - $0.206 - $0.050), as provided in the testimony of witness Ayub (USPS-T-1), Appendix 1, Page 10, revised June 7, 2006.

The "minimum" price-difference (i.e., "discount") elasticity, E_d, the only unknown, can then be "backed-out" of the equation above by solving the following:

$$\ln Q_0 = \ln Q_1 + E_d \quad \ln \frac{d_0}{d_d}$$

RESPONSE OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORY WMB/OCA-T1-5

The “minimum” price-difference elasticities for each year, calculated in the attachment to this response, are presented below.

(a) Year 1: -1.0437

(b) Year 2: -1.0358

(c) Year 3: -1.0230

Attachment to the Response to WMB/OCA-T1-5(a) - (c)

"Price-Difference" (i.e., "Discount") Elasticity,
per USPS-T-1 (Ayub), Appendix A,
Page 10 (Rev 6-7-06)

			Year 1		Year 2		Year 3	
				Log (ln)		Log (ln)		Log (ln)
[1]	WMB BR Volume	Q_o	450	6.1092476	475	6.1633149	500	6.2146082
[2]	WMB AR Volume	Q_1	713	6.5694815	750	6.6200733	785	6.6656838
[3]	Ave Rev FCM Mkt Ltrs/pc		$0.346		$0.346		$0.346	
[4]	Std Rev/pc		$0.206		$0.206		$0.206	
[5]	BR Ave Price Difference, FCM - Std Mail	d_o	$0.140		$0.140		$0.140	
[6]	Discount (last tier)		$0.050		$0.050		$0.050	
[7]	AR Marginal Price Difference	d_1	$0.090		$0.090		$0.090	
[8]	Ratio BR / AR Price Difference		1.554189	0.440954	1.554189	0.440954	1.554189	0.440954
[9]	Natural Log			2.7183		2.7183		2.7183
	"Discount" Elasticity	E_d	-1.0437		-1.0358		-1.0230	

Sources:
[1] USPS-T-1, App A, Pg 2
[2] USPS-T-1, App A, Pg 2
[3] USPS-T-1, App A, Pg 10 (REV 6-7-06) unrounded
[4] USPS-T-1, App A, Pg 10 (REV 6-7-06) unrounded
[5] [3] - [4]
[6] USPS-T-1, App A, Pg 7
[7] [5] - [6]
[8] [5] / [7]
[9] Natural Log