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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

RESPONSE OF THE UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF
THE GREETING CARD ASSOCIATION
(GCA/USPS-T41-37, 40, REDIRECTED FROM WITNESS BERNSTEIN)

The United States Postal Service hereby provides its responses to the following interrogatories of the Greeting Card Association: GCA/USPS-T41-37, 40, filed on March 7, 2000; and redirected from witness Bernstein.

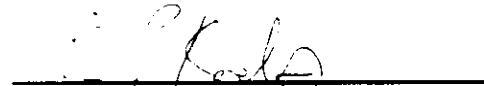
Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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March 21, 2000

**RESPONSE OF THE UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF GCA
(REDIRECTED FROM WITNESS BERNSTEIN)**

GCA/USPS-T41-37.

a. Does the Postal Service subscribe to the principle that as many of its total costs as possible should be attributed by class, subclass and rate category.

b. As a percentage of total costs for the Postal Service as a whole, and by major class, have attributable costs gone up or down in R2000-1 and in R97-1, by comparison with R94-1 and R90-1?

c. Please confirm that under Ramsey pricing, reducing attributable costs and increasing the common cost pool, e.g. by using less than 100% volume variabilities for mail processing labor costs, results in more total costs being absorbed by the most price inelastic classes of mail, and fewer total costs being absorbed by the most price elastic mail classes.

RESPONSE:

a. As generally understood in the postal ratemaking process, the attribution exercise has been conducted at the subclass level, not at the class level, and not at the rate category level. The Postal Service subscribes to the principle that the attribution exercise should be conducted with the objective of providing the most accurate possible estimates of subclass costs. By definition, accurate subclass costing will attribute to subclasses as many of the Postal Service's total costs as possible, in the sense that it is impossible to attribute accurately to subclasses any more of the Postal Service's total costs. The Postal Service, however, does not subscribe to the principle that seeking either higher or lower levels of attribution, *a priori*, is an appropriate objective of the attribution exercise, as that would conflict with the objective of providing the most accurate possible estimates of subclass costs.

b. The question is unclear as to exactly which costs are requested to be compared. In Docket Nos. R97-1 and R2000-1, the Postal Service has presented estimates of both volume-variable and incremental costs. No estimates of incremental

costs, however, were presented in Docket Nos. R90-1 and R94-1. To simplify comparisons across all four dockets, therefore, one can examine the Postal Service's estimates of volume-variable costs in the base year in each of the four cases. In Docket No. R90-1, according to witness Barker's Exhibit USPS-13C (Revised March 30, 1990), volume variable costs were 65.6 percent (25493.8/38858.9) of total base year costs. In Docket No. R94-1, according to witness Barker's Exhibit USPS-4(S)C, volume variable costs were 60.4 percent (30025.1/49751.1) percent of total base year costs. In Docket No. R97-1, according to witness Alexandrovich's Exhibit USPS-5C, volume variable costs were 56.7 percent (31146.9/54976.6) of total base year costs. In Docket No. R2000-1, according to witness Meehan's Exhibit USPS-11C, volume variable costs are 59.9 percent (35689.2/59566.5) of total base year costs. The same sources can be consulted for information about subclass costs.

c. Not confirmed. This question poses a hypothetical shift of costs from the totality of costs distributed to subclasses on a causal basis during the costing process, to the totality of costs not so distributed, and therefore allocated during the pricing process. In order to be able to state which types of subclasses of mail (e.g., more elastic, less elastic) are winners or losers in this shift, it would first be necessary to know how the shifting costs were previously distributed during the costing process. It is possible that net effect of the entire exercise could be to leave a more price elastic subclass with *more* costs, depending on the original distribution of shifting costs. This is true regardless of the approach employed during the pricing process to allocate institutional costs, Ramsey or otherwise. You cannot predict the consequences of

allocating shifting costs via the pricing process unless you know how they were previously allocated via the costing process.

The question, moreover, seems to ignore the context of the hypothesized shift in costs. The context, at least in the example given, is an improvement in the accuracy of subclass cost estimates. The objective to obtain the best possible subclass cost estimates exists entirely independent of Ramsey pricing. Moreover, the usefulness of the information provided by a Ramsey analysis applying the best available cost estimates is not diminished by the fact that its results would change relative to a Ramsey analysis applying inferior cost estimates. The results of almost any rational pricing procedures would likely change, given large enough shifts in the underlying subclass cost estimates. A Ramsey analysis is like any other pricing process, in that it simply takes the subclass costs as given. The fact that improvements in the costing process can have the effect of shifting the classification of costs (between attributable and institutional) simply has no bearing on the entirely separate issue of whether the pricing process is better informed with the availability of a Ramsey analysis.

**RESPONSE OF THE UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF THE GREETING CARD ASSOCIATION
(REDIRECTED FROM WITNESS BERNSTEIN)**

GCA/USPS-T41-40.

- a. Please confirm that Ramsey pricing would enable the Postal Service to shift the costs of R&D and investment, for example in delivery systems, needed to capture the emerging dynamic e-mail commerce package business onto price inelastic customers in First-Class mail and elsewhere.
- b. Please confirm that such cost shifting could constitute cross-subsidization where costs that could have much higher attribution, such as delivery costs, instead are largely assigned as institutional costs.

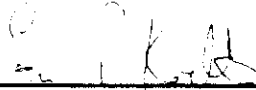
RESPONSE:

a.-b. Not confirmed. Ramsey pricing does not "enable" the Postal Service to do anything except bring useful additional information to bear on the pricing process, for use by the Postal Service, the Commission, and any other interested party. Nothing about Ramsey pricing changes the respective roles within the ratemaking process of either the Postal Service or the Commission. Moreover, the underlying premise of both portions of this question appears to be an assumption that the Postal Service has somehow failed to identify or estimate accurately the costs (more specifically, the incremental costs) of one or more subclasses. If costs that are incremental to one or more subclass are not required to be recovered through the rates for that subclass or group of subclasses, the possibility of cross-subsidization does arise. That possibility, however, is in no way related to the extent to which demand information is used, in a Ramsey model or otherwise, for purposes of improving the allocation of costs that have not been causally related to a subclass or group of subclasses. Alleged deficiencies in the costing process, if substantiated, should be rectified with improvements in the costing process.

The Postal Service submits that its proposal in this case reflects appropriate costing and, moreover, is unaware of any reliable basis for the statement that "delivery costs" could "have much higher attribution," or the suggestion that R&D costs or investment costs have not been treated appropriately.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.



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